TRANSACTION CARDS IN CANADA

Working Paper #8

Professor Richard H. McLaren
Project Director

TRANSACTION CARDS IN CANADA

Working Paper #8

Professor Richard H. McLaren
Project Director

This background paper is one of a series which has been developed in connection with a research project directed by Professor Richard H. McLaren. It is directed at identifying specific issues within a designated topic. The research project was designed to identify the "Policy and Legislative Responses to Electronic Funds Transfer" from a provincial perspective.

TABLE OF CONTENTS

TRANSACTION CARDS IN CANADA

INTRODUCTION:

It seems to be generally recognized that a magnetically encoded plastic card will be the centrepiece of any electronic funds transfer system. The credit card will also become a debit card. Whether there is to be a single card which is both a debit and credit card or whether there are two separate cards will be a question of marketing strategy.[1] The dawning of the age of E.F.T. will be marked by the emergence of the debit card. The transition phase to a complete E.F.T. system will likely utilize the debit card as a means of improving the efficiency of the cheque as a payments instrument through authorization and verification technology. It will also be a competitive mode of payment in that when transaction data is received at the card-holder's bank, the amount of the transaction would be deducted from funds in the card holder's demand deposit or savings account. Further into the future the debit card can become an instantaneous electronic transfer vehicle, which of course will mark the completion of the transition phase to E.F.T. At that time, it will be a transaction card serving as the medium for transferring deposits and for cash withdrawals.

DESCRIPTION OF CARDS:

(I) Credit Cards

(a) Kinds of Credit Cards

There are a great many different kinds of credit cards and in the sense that they can all be used to make purchases without cash or cheque, they can properly be called "credit cards", but this conceals their differences and it therefore is not a useful way of thinking of them.

The cards can be classified and distinguished on any number of bases. For example, we may distinguish the "true credit card" from the mere "convenience card." In the latter category one finds the American Express and Diners Club cards. On one theory, these are not true credit cards because the amounts charged are payable when the monthly statement is received and in fact, the user is merely relieved of having to carry cash. However, this is misleading because there is credit granted until the bill is rendered and interest is charged on overdue accounts in a manner similar to that used by the "credit cards" which are intended to be used as credit cards. Even so, it is possible to recognize the convenience card as a distinct class.

Within the class of true credit cards, i.e., where credit in respect of any particular purchase is available for as long as 20 months, there are two party cards and tripartite cards. The former are those issued by a business to its own customers for use at its retail outlets. The department store and oil company cards are examples of this type.

The tripartite cards (which can be either convenience cards or credit cards) are issued by one business to be used to effect sales between two other persons, namely the holder of the card and any merchant who has agreed to accept the card. In the true credit field the leaders of course are the bank cards, Visa and Master Charge. The tripartite cards are sometimes known as multipartite cards because of the large number of merchants who accept them and because some issuers agree to honour the use of other issuers' cards. This paper is primarily concerned with the bank credit cards.

(b) History

In 1967, four Canadian Banks - the Royal Bank of

Canada, Canadian Imperial Bank of Commerce, The Toronto-Dominion Bank and Banque Canadienne Nationale - acquired the Canadian rights to Bank Americard, one of the two major bank cards in the United States, and marketed it under the name of Chargex. These four banks introduced the Chargex plan into Ontario and Quebec during the Summer of 1968. The card was introduced in British Columbia during the Fall of 1969 with the spring and summer of 1971 seeing the expansion of the card to the Prairies and the Maritimes. Therefore, the card was not a national one until the close of 1971. The establishment of regional processing centres and the population density had determined the progression of the expansion. Each bank had also developed its own operational systems which were independent of the other bank's systems.

The Canadian Chargex member banks agreed to share costs which would result in benefits external to any one bank in the plan. These costs were primarily promotional, to educate individuals to use, and merchants to accept, the Chargex card. An inter-bank agency, known as Chargex, was set up to provide administrative, marketing and regulatory functions. It is this agency which holds the rights to the colour logo of the card, sets guidelines for the fee structure and acts as the agent responsible for remitting the annual fees to Bank Americard. It has been estimated that the banks spent between thiry and forty million dollars in start-up costs in introducing the Chargex plan. It has been suggested that the banks did not break even on their Chargex operations until some time during 1972.[2]

The Bank of Nova Scotia joined the four founding banks in the plan in 1973. It paid 9.5 million dollars to join the consortium. This money was to compensate the founding banks for the initiation fee which they had paid to Bank Americard plus the good will which they had built up through

their initiatives in setting up the system. Apparently, the Bank of Nova Scotia benefitted from this good will as it was able to break even in its operations with the Chargex card in two years of joining the system.[3]

The original four founding banks had started with a data processing system which had been developed by the Bank of America. That system required a considerable amount of manual labour and involved the setting up of regional processing centres for each of the banks in Toronto, Montreal and Vancouver. On the other hand, when the Bank of Nova Scotia joined it set up one computer facility in Toronto to facilitate nation-wide authorization. This system has proved to be relatively faster and more efficient in processing transactions than the four founding banks' systems.

In 1976 the five banks decided to change the Chargex name to Visa. National Bank Americard Incorporated had made the decision to market the card under a common logo throughout the world and the Canadian Banks decision to use the name Visa was part of the scheme to market the card internationally under one common logo to be known as "Visa." Thus, the card now has a world-wide common logo and common name.

In 1973, the Bank of Montreal and the Provincial Bank of Canada negotiated an agreement with the Inter-bank Card Association in the United States. Inter-bank had started in the United States in 1966 when eight banks in various locations in the United States organized an inter-change system for dealing with cards which would have otherwise been independent bank cards. A few years later Inter-bank bought the name Master Charge and its logo from the Western Bank Card Association. The two Canadian banks negotiated an exclusive right with Master Charge until the end of 1978. There is a diminishing degree of exclusivity from 1978 through

to 1985. The Bank of Montreal had spent the previous four years installing and updating its regional and central computer facilities in anticipation of its eventual entrance into the charge card field. When it made its arrangements for the use of the Master Charge logo it was able to set up the charge card system very quickly. It completed its nationwide distribution of cards nine months after it had signed the arrangement with the Inter-bank Card Association.

The Unity Bank was the only other Canadian bank which offered a credit card service. It had used the facilities of the American Express Gold Card. That card did not have all of the features of the bank charge card and is really not a competitor with those cards. The acquisition of the Unity Bank by the Provincial Bank of Canada in the Spring of 1978 may result in the disappearance of the card.

The Merchantile Bank and Northland Bank of Canada have not joined the system and apparently do not plan to do so because they are not consumer-oriented banks. The Bank of British Columbia probably will join one of the card systems at some point, however, it needs to further computerize its operations before doing so.[4]

The other deposit-taking institutions in Canada do not have credit card systems. Credit Unions experimented unsuccessfully with their own card but have discontinued those experiments. The Canadian Co-operative Credit Society is currently co-ordinating on behalf of the Credit Union system a study of the financial and operational implications of issuing an independent credit card or joining an established credit card syndicate.[5]

The entrance of non-bank deposit-taking institutions into the credit card field will probably follow the American principal agent arrangement, where the major banks are

affiliated with the credit card plans as principals who in turn enlist other financial institutions as agents. The banks that act as principals hold all the receivables generated by their own card holding customers. On the other hand, institutions that act as agents may be either "simple agents" in which case the principal bank holds all the receivables, or "participating agents" which share in the financing of the accounts according to a prior agreement with their principals. At the present the Trust Company legislation in Ontario allows provincially incorporated companies to have only 7% of their assets in consumer loans. A change in legislation may be required to make it profitable for many of these companies to join one of the existing bank's plans.

(c) <u>Bank Credit Card Procedure</u>

Each bank operates solely with the group of affiliated retailers who have entered into agreements with the card issuer, although many retailers enter into agreements with more than one financial institution and participate in both the Visa and Master Charge systems.

Before Master Charge was started in Canada, merchants and others who joined Chargex and thereby agreed to honour Chargex cards paid an initial sign-up charge of $25.00 plus imprinter rental of $12.00 a month. Master Charge banks did not charge a sign-up fee and both plans subsequently made an arrangement whereby the imprinter provided by other plans could be used to imprint the sales slips for both plans.

Fees for the services of the bank credit cards are now paid entirely by the retailer who is charged from 1 1/2% to 5 3/4% of his transactions. Where the retailer's and the customer's banks are different, this fee is split between them. Master Charge assigns 1% of the gross sale per draft to the customer's bank, whereas Chargex assigns it the

average rate of discount applied to the transaction by the retailer's bank, less 25 cents per draft.[6]

Following the scheme whereby each bank develops its own operational systems independent of the other banks, they also assess the credit worthiness of a potential cardholder by establishing and applying their own standards. The line of credit which is available to an individual cardholder is subject to negotiation between himself and his bank. The minimum line of credit is $300.00 under Chargex and $400.00 under Master Charge. There is no upper limit although it is rare for the banks to grant a line of credit in excess of $2,000.00. The agreement with the cardholder also permits him to obtain cash advances at the participating bank and to charge purchases at all participating outlets. The cardholders are billed once a month, receiving a descriptive billing of the transactions involved for the billing cycle. This permits the sales slips which are generated when the cardholder uses the card to be truncated upon receipt at a bank's processing centre and the relevant information captured on an electronic tape for interchange purposes. If the cardholder has not paid the account in full at the end of the billing cycle there is a grace period of 25 days in which no interest is charged, after which interest is applied at the rate of 1 1/2% per month on all outstanding balances. In the case of cash advances, the interest rate is applied from the time that the cash advance is made rather than at the end of the billing cycle. The account agreements also provide for the cardholder to be responsible for the first fifty dollars of any unauthorized use of the card unless he has provided notification to the bank prior to any unauthorized use of the card. This provision in the cardholder's agreement is the direct result of Federal legislation in the United States which limits the cardholder's legal liability to $50.00.

When a cardholder activates his account by making a purchase, the merchant is required to obtain an authorization

for the transaction if its value is over what is called his "floor limit." If the merchant fails to obtain the credit authorization, and it subsequently turns out that the card was being used fraudulently or had been revoked, the transaction can be charged back against the merchant. The merchant is required to call the authorization centre of the issuing bank, under the Chargex system. With the Master Charge system he calls the bank with which he is associated. The authorization centres make a check to ensure that the amount of the purchases is within the credit limit assigned to the card holder and that the transactions and payments record of the cardholder warrant authorization.

The merchant deposits all of his sales drafts at the end of the day with his bank in the same manner that he would deposit cheques. He is immediately given credit for these deposits less the discount on the gross amount of the sales tickets which has been established in his account agreement.

The sales tickets which have been deposited with the merchant's bank are forwarded to that bank's processing centre and from there to that of the cardholder's bank processing centre if the sales draft is not one drawn on the processing bank's system. For a more extensive description of this aspect of the transaction see the Canadian Banking Techniques Study Working Paper #3.

The financial institutions offering transaction cards in Canada are national in scope as are the card systems. This is not true of developments in the United States. As a result the Canadian system for authorization and interchange information has not been developed to the same level of sophistication as it has in the United States. Undoubtedly, these developments will occur as the economic realities and costs of credit cards become more apparent to the banks.

(II) Debit Cards

(a) Kinds of Debit Cards

The essential difference between a debit and a credit card is the lack of a credit facility for the former. The use of the card depends upon the card holder having a demand deposit account with sufficient funds to cover the transaction. The amount of a transaction would be deducted from funds in the card holder's demand deposit account when the sales draft created by the utilization of the debit card reached the cardholder's bank.

Undoubtedly there would evolve a number of different types of debit cards as time goes on. At the present time, there are no operating debit card systems in Canada from which to draw a description of possible kinds of cards. It has been suggested that the debit card could take the form of a money card.[7] Such a card would have a pre-encoded monetary limit. Each time the card was used the limit would be reduced until it reached zero. At this point the card would have to be recharged.

A different type of debit card has been emerging in the United States. The scheme which will be introduced during 1978 by Master Charge and Visa involves a paper-based debit card plan.[8] The card permits a cardholder to make purchases at merchants honouring the debit card by initiating a debit transaction against a chequing or savings account. The systems which are being designed will utilize the existing credit card authorization systems and other systems such as restricted card bulletins. It is being developed to service that segment of the market which does not wish to utilize credit cards.

(b) History

As has been pointed out there are no debit card systems currently operating in Canada. However, the Canadian

Co-Operative Credit Society, in connection with its current study of the implications of issuing credit cards, has undertaken on behalf of the Federal de Quebec des Caisse Populaires des Jardins' Quebec, an assessment of their debit capability.[9]

The Caisse Populaires debit capability enables any Caisse Populaire member in Quebec to go to any other Caisse Populaire in Quebec and on presentation of an identification card make a withdrawal on his account at his particular credit union. This system could be easily and quickly expanded to include merchants, at which point it would be a debit card system. At present it is a partial debit card system in that it enables money to be obtained at different Caisse Populaires from the ones in which the funds are actually deposited.

(c) Probable Card Procedure

There being no operating debit card system in Canada it is impossible to describe any actual procedure. The procedure which is likely to emerge is that which is being developed in the United States. That system is essentially an additional capacity of the present scheme for operating credit card systems. Master Charge, which is introducing a debit card program to be known as Signet, will have to sign up merchants and cardholders in the same way as it did in developing its credit card system. In all likelihood the system will operate in a very similar fashion to the present procedures with credit cards. It is, therefore, likely that the contracts establishing the relationship will be very similar to those currently being used with credit cards. Furthermore, the entire procedure is likely to operate in a similar fashion to that of credit cards with the one exception, that there will be no credit involved in the utilization of the card. The remainder of this paper assumes that the relationship between debit cards and credit cards from the legal point of view is similar, if not, identical. Where it is thought that there

may be any differences they will be pointed in.

(III) Contractual Framework for Use of Transaction Cards

The present bank credit card system is ostensibly created by contracts, as will be the debit card system when it is introduced. The contracts which govern the relationship all centre on the card issuing institution as one party to the contract. The card issuing institution will have a contract with its cardholder , another contract with a participating merchant and further contractual relationship with the other participating card issuers. This part of the paper sets out the relationship of one party to the other two parties in the contractual arrangement. It should be noted that credit card transactions are not determined by contract law alone. The relationship is also affected by existing statutes and rules of law. A good example is section 191 of the Bills of Exchange Act. It purports to preserve consumer defences as against holders of consumer bills or notes in spite of any contract to the contrary.[10] The characterization and consequences of the relationship of one party to the other, aside from contract law, are discussed in the section immediately following the present description of the contractual relationship.

The Visa card, formerly Chargex, operates in the following fashion. The bank enters into an agreement with merchants[11] which provides that they will sell goods and services to cardholders on cash terms and complete a sales draft in the prescribed form. The merchant must maintain an account at a branch of the contracting bank, and must deposit his drafts there within three days of the sale for which they were written. The bank agrees to credit the merchant with the value of the drafts, less the bank's discount, upon delivery.

The agreement also provides that the bank may charge

back (to the merchant) the value of drafts made in certain circumstances. These include when the cardholder claims a draft is forged, when merchandise is returned to the merchant, when the draft is in excess of the floor limit and not authorized, and when the draft was made on an expired card. It will be noted that the bank shifts most of the risks arising from commerce onto the merchant. This will be more apparent after the following comments on the card holder's agreement.

The contract between the consumer (cardholder) and the bank[12] provides that the cardholder will pay the amount of all drafts in respect of which the card has been used, within 25 days of billing, either in full or in an amount not less than 5% of the balance or $10.00. Note that the agreement says "drafts in respect of which the card has been used." This may be wide enough to include drafts made up only by the inscription of the card number, without a signature - although, the bank merchant agreement requires the drafts to be properly completed as a condition for payment. The agreement also provides for the payment of interest on unpaid balances, that the holder is responsible for unauthorized use until notification of the bank, up to $50.00, and that all disputes arising out of sales in which the card was used are to be resolved by the merchant and the cardholder alone.

Now that the basics of the contractual system are clear, the process of characterization can begin. The credit card is a hybrid, a new commercial device having the characteristics of many of its predecessors. The object of examining the characterizations is to note the different qualities of credit cards with a view to determining which device they must closely resemble in form and function. This decision is important in that it potentially can effect the choice of possible legal regimes which may apply to credit cards. Any particular characterization, if applied to credit cards, can lead to

results which are diametrically opposed to the contractual provisions. At the present time such an exercise is somewhat speculative because of the total absence of judicial decisions in Canada. Nevertheless, it is necessary in order to set the background for an analysis of issues arising out of an EFT environment.

CURRENT LEGAL STATUS OF CARDS

As was indicated above, the character and consequences of the relationships of one party to the other, coupled with the nature of the credit card transaction are not determined entirely by contract law. The credit card transaction can be characterized in a number of ways. In fact, credit cards touch so many legal concepts, they, with their transactions can be characterized as any of the following:

1. Negotiable Instruments
   (a) Cheques
   (b) Bills of Exchange
   (c) Promissory Notes
2. Letters of Credit
3. Assignments of Receivables (factoring)

The characterization of credit cards as one of the above is of ultimate importance because it entails the determination of what rights and liabilities exist for the parties to the transaction. Among the rights that are effected are: the right to countermand, i.e. to stop payment or charge back, the liability for loss or unauthorized use, the existence of customer defences to actions brought by merchants for the price of defective goods, the right to charge interest and other less important matters.

The two possible characterizations of negotiable instruments and letters of credit are examples of what is known as the direct obligation theory. That is to say the liability of the

consumers to pay the bank is direct as opposed to the assignment theory which is typified by the analogy of the factoring on accounts receivable. The primary difference in these two theories is that in the latter the bank has no direct relationship with the consumer respecting payment. Rather, the bank takes whatever rights the merchant has against the customer as a result of the sale transaction. The effect of this is that in an action for payment by the bank, the customer can assert defences relating to the quality of the goods sold to him by the merchant.

(i) The Negotiable Instrument Characterization

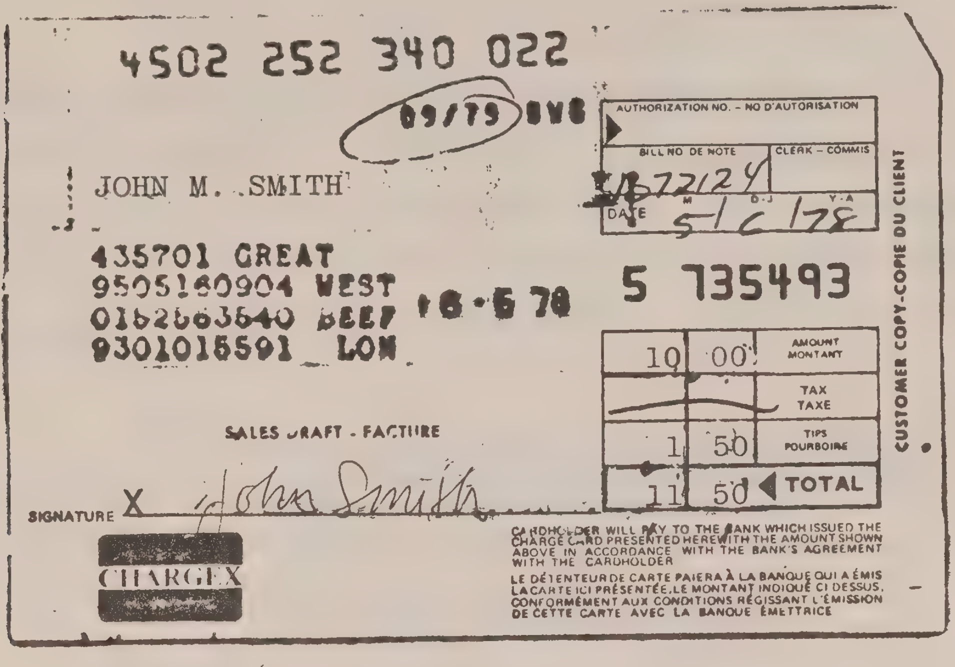
Blacks law dictionary defines "negotiable" as

> "capable of being transferred by endorsement or delivery so as to pass to the holder the right to sue in his own name and take free of equities against assignor payee"

Strouds provides the following definition:

> **NEGOTIABLE.** (1) "It may be laid down as a safe rule that where an INSTRUMENT is, by the custom of the trade, transferable, like cash, by delivery, and is also capable of being sued upon by the person holding it *pro tempore*, there it is entitled to the name of a negotiable instrument, and the property in it passes to a bona fide transferee for value, though the transfer may not have taken place in MARKET OVERT. But if either of the above requisites be wanting—i.e. if it be either not accustomably transferable, or, though it be accustomably transferable, yet, if its nature be such as to render it incapable of being put in suit by the party holding it *pro tempore*—it is not a negotiable instrument: nor (apart from the question of estoppel) will delivery of it pass the property of it to a vendee, however bona fide, if the transferor himself have not a good title to it and the transfer be made out of market overt" (1 Sm. L.C. 456, summarising *Miller* v. *Race* and its cognate authorities, and quoted with approval by Blackburn J., *Crouch* v. *Credit Foncier of England*, L.R. 8 Q.B. 381, 382). See further *Taylor* v. *Kymer*, 3 B. & Ad. 320.

The following is a facsimile of a typical sales draft for further reference:


4502 252 340 022

09/79 BVB

AUTHORIZATION NO. – NO D'AUTORISATION

BILL NO DE NOTE | CLERK – COMMIS

JOHN M. SMITH

DATE 5/6/78

435701 GREAT
9505160904 WEST
0162663640 BEEF
9301016591 LON

5 735493

10 00 AMOUNT MONTANT

TAX TAXE

1 50 TIPS POURBOIRE

11 50 TOTAL

SALES DRAFT - FACTURE

SIGNATURE X John Smith

CHARGEX

CARDHOLDER WILL PAY TO THE BANK WHICH ISSUED THE CHARGE CARD PRESENTED HEREWITH THE AMOUNT SHOWN ABOVE IN ACCORDANCE WITH THE BANK'S AGREEMENT WITH THE CARDHOLDER

LE DÉTENTEUR DE CARTE PAIERA À LA BANQUE QUI A ÉMIS LA CARTE ICI PRÉSENTÉE, LE MONTANT INDIQUÉ CI DESSUS, CONFORMÉMENT AUX CONDITIONS RÉGISSANT L'ÉMISSION DE CETTE CARTE AVEC LA BANQUE ÉMETTRICE

CUSTOMER COPY-COPIE DU CLIENT

Before dealing with the specific varieties of negotiable instruments the following observations upon the Visa system described above should be made. Note in particular that the obligation to make, or the right to receive payment in the amount of the draft flows, from the cardholder, through the merchant, to the bank, and that it accrues to the bank upon delivery of the draft, subject of course to the terms regarding the time for payment. Recall also, that disputes regarding the merchandise are to be resolved without involving the bank. Presumably this means that the bank will not be subject to any equities existing between the consumer and merchant. It is submitted that these are elements of negotiability which suggest that the drafts are some kind of negotiable instrument. Moreover, it is to be observed that oil company drafts are negotiated to the oil companies as payment for fuel deliveries. Finally, although it is not strictly relevant, it may interest the reader to know that the ancestor of the Visa draft, the Bank Americard draft

was drawn as a negotiable instrument. It appeared as a bill of exchange drawn by the merchant upon the customer, payable to the card issuer or order and accepted when the customer signed it.[13] The Visa draft does not have this form[14] but that does not mean that it is not negotiable in substance.

In Canada, the Bills of Exchange Act codified the rules regarding certain negotiable instruments, namely bills of exchange, cheques, and promissory notes.[15] Whether credit card drafts are similar to any of these will now be considered.

A bill of exchange is defined by section 17 of the Act as follows:

> Bill of exchange defined
>
> **17.** (1) A bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay, on demand or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person, or to bearer.

The requirements of a bill are discussed below:

It must not be payable on a contingency.[16] Sales drafts would appear to meet this requirement. They are paid on delivery so long as properly completed. Even when a charge back takes place the draft is paid first, then charged back. In this regard see clauses 3 and 4 of the merchant-bank Agreement. The former says "upon delivery of ... a properly completed draft ... the bank will immediately credit the account..." The latter says, "the bank may refuse the credit ..." and then enumerates the circumstances when credit may be refused. Whether these provisions render the drafts contingent is a crucial matter. It is submitted that they do not in that the circumstances of clause 4 merely define an improperly completed draft. They do not make the payment of a proper draft contingent in any way. Moreover, the practise is certainly to credit the accounts, then to audit the drafts and make charge backs.

It must be an order to pay, not a precatory request,

although the addition of terms of courtesy will not make an order precative.[17] This presents some difficulty as the drafts do not say "pay to bearer". There is however this inscription.[18]

> "Card holder will pay to the bank which issued the charge card presented herewith the amount shown above in accordance with the bank's agreement with the card holder".

When it is remembered that a bill does not require any special form of words[19] and that the draft is drawn on the customer by the merchant,[20] it seems quite reasonable to conclude that the draft is in "order" form.

To continue, <u>a bill must be addressed by one person to another</u>.[21] In the case of a Visa draft, the addressee would be the customer and it will be noted that the customer's name is imprinted on the draft.

A bill must <u>be signed by the person giving it</u>.[22] Drafts comply, it is submitted, because the name of the merchant is mechanically signed by the imprinter. See the example above.

The final requirements are that <u>the bill be for a certain amount</u> and <u>payable at a determinable future time if not on demand</u>.[23] These are clearly met as the amount is indicated plainly on the face of the drafts which are payable on demand.[24]

Accordingly, the following is submitted: It is within the limits of reasonability to conclude that a Visa sales draft is a bill of exchange within the meaning of that Act. It is clear that such drafts are not <u>obviously</u> bills, but they are used as such and their features are capable of being interpreted as fulfilling the requirements of bills. Against this position it can be argued that such a characterization overlooks a major feature of the credit card transaction, namely, the extension of credit by the drawee bank. When the drafts are delivered to the bank they are not presented for payment in the technical

sense, it is rather the credit arrangement with the customer that governs the collection of the draft and the interest charges. In fact, the drafts are never presented to the drawee, he is "presented" with a billing statement which refers to all the drafts drawn upon him by various merchants.[25]

The consequence of finding, at some point in the future, that drafts are bills would be that the rights and liabilities of the parties to a sales draft would be determined by the numerous explicit rules governing bills of exchange at common law and under the statute. There are, for example, rules covering the rights and obligations of each party regarding payment and collection, including endorsers, and the consequences of forgery (unauthorized use). This would eliminate much of the uncertainty now surrounding the consequences of credit card transactions.

Cheques and promissory notes are specialized forms of bills of exchange. It has already been concluded above that it is possible to consider the credit card transaction as one which is governed by the bills of exchange characterization. It appears to also be possible to make the analogy of the sales draft to that of a cheque or promissory note, those being merely specialized forms of bills of exchange. The next two sections attempt to develop those analogies.

(a) <u>Sales Draft as a Cheque</u>

It has been recognized in the United States that another analogy can be made between sales drafts and cheques.[26] This is based on the notion that the credit card system is functionally related to the cheque system. This functional relationship is established by examining the paper flow involved in credit card transactions. The card issuer will issue forms, i.e., drafts rather than cheques. These drafts are then used to record transaction of payment, as would a cheque.

The draft is later presented to the merchant's bank where credit is given and subsequently a draft is cleared to the cardholder's bank, who is in turn paid by the cardholder.

From the functional analysis of the paper flow in a credit card transaction inference is made that it is very similar to the cheque system with the primary alteration being the mechanically imprinted sales draft.

Let us now examine this analogy in the Canadian context. Cheques are defined by section 165 of the Bills of Exchange Act as follows:

> Cheque defined **165.** (1) A cheque is a bill of exchange drawn on a bank, payable on demand.

Clearly the operative part is sub-section 1. A cheque must be a bill of exchange, and we have seen that a sales draft may be a bill of exchange. It follows therefore that a draft may be a cheque. Secondly, note that a cheque must be payable on demand. The Visa draft as we have seen is in demand form. The problem is, cheques must be drawn on a chartered bank but in the bill of exchange analogy the drawee was the customer. Actually this is no problem for there is nothing preventing a further characterization of the sales draft as being drawn on a bank. Examine the draft included above, the name of the bank is encoded in the card number at the top, this is the drawee to whom the cheque is addressed.[27] The payee is clearly indicated, and the drawer signs on the bottom line. The only difference between this and the bill of exchange theory is that we have based the document on the credit of the customer with his bank (that is his Visa account) instead of basing it on the merchant's credit vis-a-vis the customer to whom he has sold merchandise.

The analogy of the sales draft to a cheque breaks down on one critical factor. Coupled with the giving of the cheque there is an implied promise from the drawer that he has

funds on deposit at the bank sufficient to pay the amount of the cheque.[28] This promise must of necessity be absent by the very nature of the credit card transaction. What the merchant relies upon is the contractual promise of the card issuer to him that he will receive payment from the bank, less a discount. Therefore, although it could be argued that the sales draft paper flow is very similar to that of cheques and therefore the laws relating to cheques should govern sales drafts, the strict application of the Bills of Exchange Act and the case law would not permit the rules to be applied to sales drafts.

(b) Sales Draft as a Promissory Note

As we have seen, a bill of exchange is meant to be used as a method of payment. A promissory note on the other hand is meant to be a device for continuing security,[29] but it can be used to effect payment. Accordingly, it is at least reasonable to inquire into whether sales drafts are promissory notes.

Promissory notes are defined in section 176 of the Bills of Exchange Act as follows:

> Definition **176.** (1) A promissory note is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money, to, or to the order of, a specified person, or to bearer.

One has only to refer to the sample draft above to see that it is possible that all the requirements of the section are met. The customer is the maker, and in signing the draft he engages to pay the amount on the draft to another person, the bank. Words to that effect are plainly inscribed on each draft. It is also plain that there are no conditions attached to the payment other than those in the cardholder-bank agreement, and as we have seen those conditions cannot in any case (except for unauthorized use after notice) make the

promise conditional. When disputes arise between the customer and the merchant over merchandise, the bank must be paid, and the dispute resolved independently. In the case of a charge back, the obligation of the customer to pay the amount of the draft is not vitiated because there is nothing in the cardholder-bank agreement to that effect. One assumes that in order to make the charge back work, the bank merely foregoes its right to be paid by the cardholder.

The problem with this characterization is that it concentrates on the debt between the cardholder and the bank to the exclusion of the initial indebtedness of the cardholder to the merchant for the price of the goods. The promissory note analogy breaks down when one realizes that apart from his contract with the bank, the merchant would not part with goods in exchange for a promissory note in favour of another. Similarly, apart from that same contract, the bank would be under no obligation to give value for a note in its favour. These two inconsistencies do not make it impossible for drafts to be promissory notes, they merely make it awkward and unnecessary for this to be so. Why strain this analogy when the transaction is in reality governed by the contracts?

Before leaving the subject of promissory notes it should be noted that if the draft said "the cardholder will pay to the merchant named above" instead of the bank, the analogy would be closer because the merchant payee could be said to endorse the drafts (notes) to the bank for value and the bank could then collect them.[30] This is so because an endorsed note creates obligations which are essentially the same as an accepted bill. The following excerpt from Falconbridge demonstrates this neatly.[31]

> While a promissory note continues in its original condition as simply a promise by one man to pay another, it bears no resemblance to a bill of exchange. When it is endorsed, the resemblance begins; for then it becomes an order by the endorser upon the maker of the note (his debtor by the note) to pay to the endorsee (*a*). If the bill is also accepted, the resemblance between the bill and the note is close.
>
> If B draws a bill upon A payable to C, and A accepts, the bill becomes a promise to pay on A's part, accompanied by an order addressed by B to A to pay the amount to C. So, if A makes a note payable to B, and B endorses it to C, the note becomes a promise to pay on A's part, accompanied by an order addressed, in effect, by B to A to pay the amount to C. In other words, the three parties are in essentially the same position as regards both instruments. If the bill in question, instead of being originally payable to C, were drawn payable to the drawer's order, and were endorsed by B, as well as being accepted by A, the analogy between the two instruments would be perfect. In each case B would be the endorser of the instrument as well as the drawer of the order. A would be the person to whom the order is addressed and who promises to pay, and C would be the endorsee.

The significance of these observations on promissory notes is that if sales drafts are promissory notes or are sufficiently similar to be analogous, then the established body of law governing notes could govern and regulate the use of credit cards.

(c) Common Law Negotiable Instruments

All of the foregoing attempts to characterize credit card transactions as negotiable instruments have been based on the statutory rules embodied in the Bills of Exchange Act. It was a codification of the common law of Negotiable Instruments and the Law Merchant. It is possible to develop a further characterization which attempts to place credit card transactions within the common law of Negotiable Instruments and Law Merchant without the inference of the statutory rules.

A unique characteristic of the law relating to negotiable instruments is that trade usage and custom can become rules

of law when they are ratified by the court. The reason for this is that more so than any other field, "the law merchant ... is not fixed and stereotyped, but is capable of being expanded and enlarged so as to meet the wants and requirements of trade in the varying circumstances of commerce."[32] The rule may have been stated by Lord Campbell in Brandao v. Barnette[33] as follows:

"When a general usage has been judicially ascertained and established, it becomes part of the law merchant, which courts of justice are bound to know and recognize." The amazing thing about this rule is that it means that "any time people treat a document as a negotiable instrument, and yet the document does not satisfy a requirement, the courts may look at trade usage and custom to find a solution."[34] An example of this can be found in Miller v. Race[35] wherein it was held that the property in goldsmiths and bankers' notes passed on delivery because they were treated as money in the ordinary course of business.

It is submitted that a court could find that sales drafts are negotiable instruments on the basis of their trade usage as described above. The method of proving this to a court is described in detail in Falconbridge at pages 9 and 10.

As King noted in his analysis of travellers cheques,[36] when instruments which are not statutory negotiable instruments are treated as negotiable in the general sense, this does not enlighten us as to the rules governing the rights and duties associated therewith in any particular case. Mr. King says there are two answers to this.

He says, "one approach is to establish certain basic premises and then, keeping these premises in mind, follow

the statute as far as is applicable."[37] King noted that this technique was used to discuss rules for travellers cheques by Ellenger.[38]

The second approach identified by King[39] involves drawing the central meaning out of each particular section of the statute so as to determine the general rules governing negotiable instruments. It is assumed that the statutes are codifications of the common law and the law merchant. King criticizes both of these modes. In the first he says there is a problem determining the basic assumptions, i.e., the basic nature or use of the instrument in question, and then he says the current statutory rules can conflict because of the distinctions between bills, notes and cheques which do not have any meaning in the context of the novel negotiable instrument. The problem of the second approach is that it requires a personal interpretation of statutes and that the statutes themselves may not be just a codification of the common law.

It appears that both of these approaches amount to the same thing which is best described in terms of the first. Which is, again, identifying the nature of credit cards, and adapting to that, the rules for negotiable instruments of similar nature. King, in any event, chose the first approach as being the least controversial.[40]

In applying the "first approach" to the subject of credit card transactions we must first determine the true nature of credit cards as disclosed by custom and usage. This probably includes the following propositions:

1. The primary (ultimate) obligation created by a credit card transaction is that the cardholder will pay the value of the draft to the bank.

2. Drafts are negotiable and the holders take free of equities.

3. Intermediaries (like the merchants) can receive value for the drafts.

4. The cards themselves are non-negotiable.

5. Transactions can be charged back.

(d) Conclusion

It is possible to superimpose upon the basic contractual relationships between the parties to a credit card transaction a characterization that the transaction is that of a negotiable instrument. It is unlikely that the characterization could be extended to the specialized notions of negotiable instrument embodied in the concepts of cheques and promissory notes. Nevertheless, it is a possible characterization that credit card transactions are negotiable instruments either within the Bills of Exchange Act or partially within that act and partially under the common law of negotiable instruments. The characterization of a credit card transaction as being one of a negotiable instrument results in certain rights and remedies being established. Those rights and remedies are discussed after the next two characterizations have been dealt with.

(ii) The Letter of Credit Characterization

There is already a well established body of law on the subject of letters of credit as the device was in use from the beginning of this century. So again, that law with suitable modifications could regulate credit card transactions if there was sufficient similarity between the two.

"A letter of credit is a request in writing from one party (usually [but not always] a bank) to another party (usually a seller) to advance money or give a credit to a third party (the customer) on the basis of the issuer's promise to pay for any credit or cash extended under the terms of the letter."[41] The letter may be addressed to no one particular, and if not, it is known as a general letter. The terms of payment by the issuer may be on demand, in which case it is a clean letter, or there may be a condition that documentary proof of delivery of merchandise to the customer be provided. There can apparently, be any kind of condition imposed on payment.[42] Letters of credit may be revokable or irrevokable according to their terms. The last feature of the letter of credit is that the customer usually agrees to pay the issuer for any credit extended plus a fee for the benefit of the service. Sometimes a third party undertakes to indemnify the bank, instead of the customer.[43] The document itself is non-negotiable.[44] The main function of the letter of credit is to substitute the credit of the bank of known solvency for that of the unknown customer. This promotes commerce by inducing merchants to make sales on credit which they would otherwise not make.

The letter of credit transaction commences when the customer applies to his bank for such a document. These two parties agree on terms and a contract is made. Then the customer presents the letter to a seller who does not know him but knows of the bank and its solvency. When the seller agrees to extend credit to the customer as requested in the letter, a contract is formed between the seller and the bank[45] to the effect that the bank will pay the seller the amount of the credit according to the terms of the letter. Finally, the customer pays back the bank and the cycle of payments is complete. The similarities between this system and the actualities of credit cards are obvious.

To get a letter of credit a person applies to a bank which will assess his credit risk. In the case of a credit card, the procedure is the same, except in the case of unsolicited cards, but either way the purchase is the one that decides whether he needs or would use the card if one was available to him. The bank's approval of the application and the imposition of terms is the same with respect both to use and payment, in that in both systems the bank dictates who the device may be presented to, and how and at what cost repayment will be made. In one scheme a letter is issued, in the other a plastic card. The card is addressed to no one in particular and a letter of credit need not be either.

The letter states the terms upon which the issuing bank will pay sellers. The same terms are known to the merchant participating in Visa, because they are spelled out in the merchant-bank agreement. The unknown customer in both cases is given credit and the seller looks directly to the bank for payment. In the case of a letter of credit, the extension of credit creates a debt between the bank and the seller, in the case of the card, the indebtedness is created when the drafts are presented in accordance with the bank-merchant agreement. In both regimes the customer has a contractual obligation to repay the bank.

Several authors have observed some differences which appear to be insignificant. Thompson [46] noted that the credit card could not on its face be a letter of credit there being no express request for the extension of credit. He argued that the merchant-bank agreement and the card constitute the letter. However, he did mention that the request to extend credit could be implied from the card alone and its use, although he thought that would be unwarranted. The inference is certainly not all that unreasonable when one remembers that merchants contracted with the bank to make sales on the card on cash terms but for no cash. He noted further that

if the card and the bank merchant agreement constituted the letter of credit, there was a pre-existing engagement by the bank to pay the merchant for credit extended to the cardholder. In the case of the letter of credit there is no such pre-existing obligation as the duty to pay arises when the letter of credit is accepted. Even Mr. Thompson realizes, however, that there is no actual obligation on the card issuing bank until the card is accepted by the merchant and is used. Accordingly, it is submitted that this observation is not significant. Another comment was that a letter of credit is given to one person whereas millions can obtain credit under the merchant bank agreement.[47] Although true, this does not appear to go to the heart of the matter.

Another commentator, Mr. McInnes, says that in a credit card transaction the merchant is under an obligation to verify the signature and validity of the card and that this would give rise to defences that are not apparent in the letter of credit transaction. But a bank is not obligated to pay a draft on a letter of credit that does not comply with the terms of the letter, as for example, if shipping documents were missing. Therefore, the criticism does not appear to have a great deal of validity.

As a final rejection of the letter of credit analogy Mr. McInnes notes that different people instigate the use of letters of credit and credit cards. The latter being a product of banks and businessmen, the former being initiated by the customer. Even if there were only unsolicited cards in circulation, this would be a weak objection to the analogy. However, since unsolicited cards are now prohibited by legislation in some provinces, it must be admitted that the use of credit cards is instigated, most of the time, by the consumer applying for a card. The objects and the mechanisms of the letter of credit and the credit card are all too similar to reject the analogy.

Like the negotiable instrument characterization the letter of credit characterization is not a perfect fit with the existing concepts involving letters of credit. Nevertheless, the characterization does cover many of the features of the credit card transaction. Once again, the imposition of this characterization upon the contractual agreements between the parties involved will result in certain legal rights and obligations which would otherwise not be present. Those rights and obligations are discussed after an examination, which follows, of characterizing credit cards as factoring.

(iii) <u>The Assignment of Receivables (Factoring) Characterization</u>

The negotiable instrument and letter of credit characterization use as their fundamental theoretical structure the direct obligation theory. The factoring of accounts receivable characterization is based upon the theory of assignment. It is the only characterization which uses this theory. Credit factoring has been described in the following manner:

> "Credit factoring may be defined as a continuing legal relationship between a financial institution (the factor), and a business concern (the client) selling goods or providing services to trade customers (the customers) whereby the factor purchases the client's book debts either with or without recourse to the client, and in relation thereto controls the credit extended to customers and administers the sales ledger." [48]

Immediately it should be noted that two species of factoring have already been alluded to, namely, non-recourse (or old-line) and recourse factoring. This distinction is crucial but simple. In non-recourse factoring the factor

assumes the client's credit risk. If the customer cannot, or will not pay, the factor must collect himself or absorb the loss. In recourse factoring the factor can debit his client's account with amount of a bad debt. Recourse factoring has existed in Canada since 1951 and in England since the 1960s. In America, however, the assumption of the credit risk, by the factor, was held to be the essence of factoring until the 1960s.[49] This may explain why American definitions of factoring stress the lack of recourse to the client. Messrs. McInnes and Gropper in their respective analyses of credit cards both say that there is no recourse to a factor's client and appear to be wrong on this point. This is significant because recourse is analogous to the charge back, one of the most distinctive features of the credit card transaction.

The mechanics of credit factoring are as follows: the factor and the client enter into an agreement which provides that the client will sell all its debts to the factor, that the debts are valid, that the factor will assume the credit risk of approved debts or that it will have recourse in certain events, and that certain forms and procedures are to be used and followed.[50] Thereafter, the client generates receivables in the ordinary course of business and these are sold, if approved, to the factor who gives value for them. The customer pays the account to the factor and is discharged by doing so.

It is submitted that the credit card system is very similar to credit factoring. It is quite plain that the bank-merchant agreement is comparable to the factoring agreement. Both provide for the assumption of certain debts by a financial institution upon approval. Furthermore, in both schemes the customers' dealings with the merchants are complete when the sale is made. The customer pays only the financial institution. Similarly in both systems the merchant is given

value for his sales credit, i.e., his book debts. Again, a bank will not give value for unauthorized debts (e.g. those exceeding the agreed floor limit), nor will a factor buy unapproved accounts. In the credit card system the bank can charge back the value of sales drafts which the customer refuses to pay because the goods were defective. Likewise, although some authors have overlooked this, factors can debit the account of their client in the same circumstances. Finally, in both schemes, the customer is discharged only when the financial institution is paid. Another feature of the credit card system is that the bank can sue in its own name to collect the value of sales made by merchants. This, of course, is due to the contractual relationship of the bank to the cardholder, but if we put this in an assignment framework it still works. An assignee must give notice to the debtor before it can sue in its own name because of section 54 of the Conveyancing and Law of Property Act and it will be noted that each sales draft contains such a notice.

Again, Mr. McInnes has criticism. He points out that banks dealing in credit card transactions do not buy all the accounts receivable of any particular merchant. Although it is usual for factors to buy all accounts of its clients, this does not appear to be essential.[51] It would seem, however, that such would be a business expedient as it would avoid duplication of accounting. He also protests that a factor, as an assignee, is subject to the equities between his client and his customer, whereas, the credit card merchant-bank agreements expressly to exempt the bank from such defences, either with the section which says disputes will be settled between the cardholder and the merchants, or the one that provides for charge backs. Section 42 (a) of the Consumer Protection Act, does not apply to the credit card transaction so the "cutoff" is effective. In any event, the factor has a clause in his agreement which effectively accomplishes the

same thing by recourse. Gropper opines that the analogy is difficult because in a credit card system there is a pre-existing contractual relationship between the customer and the bank whereas there is none in the factoring system. He also suggests that since the credit card is used for payment there never is a debt between the customer and the merchant which can be assigned. This I submit overlooks the legal reality that the customer is indebted to the merchant as soon as he offers to buy the merchandise and the merchant agrees to sell it. The similarities between the credit card system and factoring are too great for that characterization to be rejected.

(iv) Summary

The foregoing demonstrates that there are three possible characterizations which can be placed upon the credit card transaction and superimposed on the contractual arrangement. The different legal characterizations result in different rights and responsibilities for the same transaction. The various legal consequences depending upon which characterization is used are discussed in the next section under the following three headings:

1. Liability for unauthorized use

2. The nature of the charge back mechanism

3. The effect of defects in goods purchased with credit cards

(a) Liability for Unauthorized Use

For present purposes, unauthorized use of a credit card means use by an individual other than the cardholder. In other words, someone forging the cardholder's signature on sales drafts prepared in connection with the use of the card. The Visa cardholder's agreement attempts to

shift the burden of unauthorized use on to the cardholder with the following words:

> "The cardholder is responsible for all indebtedness resulting from authorized use of the card, and up to an aggregate maximum of $50.00 from unauthorized use until notification of loss or theft thereof has been received by the bank."

This represents only one type of approach to loss shifting taken by card issuers.[52] Initially, the agreement stated that the cardholder was liable for all purchases made with the card until it was surrendered.[53] Such a clause was strictly construed in Magnolia Petroleum Company v. McMillan (1943), 168 S.W. (2d) 881 where the cardholder lent his card to two friends who went on a spree with it. The court found that the holder was liable for all purchases made with the card. However, in Gulf Refining Co. v. Williams Roofing Co. (1945) 186 S.W. (2d) 790, the court refused to enforce a similar clause where there was collusion between the fraudulent holder and the merchant who honoured the card. The case may well also be authority for the proposition that negligence on the part of the merchant in accepting the card may relieve the genuine cardholder from liability. Following these cases the issuers in the United States inserted, "liability until notice," provisions in the contract, and although these are more reasonable, they did not clarify the judicial thinking on the subject. Again, in some cases the clause was held to be determinative of liability yet in others it was held that the true holder was only liable under such a clause if the merchants exercised due care in accepting the card from the fraud. The $50.00 limit was imposed in the United States by the Truth in Lending Act, 15 U.S. C. par. 1643 (a) (1970). In Canada there have been no cases on the subject, perhaps because the banks as a marketing strategy do not often enforce the clauses which would allow them to collect from the

cardholder. It is clear that the intention of the agreement is to shift the loss onto the cardholder, at least up to an arbitrary limit. All of this suggests that if the parties agree that the holder is liable in the first place then he will be. This may well be true, but we shall see that if a characterization which downplayed the contractual aspect of credit card transactions were made to apply, the cardholder might not be liable at all. Then the question would be which characterization would take precedence and be determinative.

If sales drafts are in reality bills of exchange, then it is submitted the merchant would bear the loss resulting from the forgery of the true customer's signature. This would be by virtue of section 49 and 130 of the Bills of Exchange Act. Recall that in the bills of exchange theory, the bill is drawn by the merchant upon the customer payable to the bank and accepted by the customer. If the customer is a fraud the acceptance is a forgery and the true cardholder cannot be liable on the bill. Section 49 states:

> "Subject to this Act, where a signature on a bill is forged, or placed thereon without the authority of the person whose signature it purports to be, the forged or unauthorized signature is wholly inoperative, and no right to retain the bill or to give a discharge therefor or to enforce payment thereof against any party thereto can be acquired through or under that signature, unless the party against whom it is sought to retain or enforce payment of the bill is precluded from setting up the forgery or want of authority."

Falconbridge explains the section on page 556 of the 7th edition as follows:

> "The general principle stated in section 49 is superficially simple, namely, that a forged signature or signature placed on the bill without the authority of the person whose signature it purports to be is a nullity, and consequently that a

> forged or unauthorized signature cannot be a valid link in the chain of title to a bill or the basis of the liability on the part of the person whose signature it purports to be, and that the forgery or want of authority is a real defence available even against a holder in due course".

This means the acceptor, the customer, cannot be liable on the bill, that is in our hypothesis the sales draft, which is forged. Who then is liable? It appears to be the merchant by virtue of section 130 of the Act. It states:

> "The drawer of a bill, by drawing it, engages that on due presentment it shall be accepted and paid according to its tenor, and that if it is dishonoured he will compensate the holder or any endorser who is compelled to pay it, if the requisite proceedings on honour are duly taken; is precluded from denying to a holder in due course the existence of the payee and his then capacity to endorse".

The merchant, as has been said is the drawer and as the customer's refusing to pay the forgery would amount to dishonour, by virtue of section 95, the merchant would be obliged to indemnify the holder (the bank) who had paid it.

To recapitulate, we have seen that the bank card holder agreement attempts to shift the burden of losses from forgery on to the card holder but we now see that if credit sales drafts are characterized as negotiable bills of exchange then the loss from forgery will be placed according to the Bills of Exchange Act and the common law of negotiable instruments. That is to say, losses will not fall where the agreement says they will but upon the drawers of the bills, the merchants, unless precedence is given to the contract.

The more specialized forms of Bills of Exchange of cheques and promissory notes would result in an allocation of loss for unauthorized use similar to that for the general bill of exchange. However, in the case of cheques there might also be a possibility of the bank being liable for having accepted a forged document.

If the characterization of the sales draft as a letter of credit is used the loss will be either with the merchant or the bank. The unauthorized use results in a forged claim for payment being made to the customer's bank. If the bank detects the forgery it need not pay it and the merchant would have to bear the loss. However, if the bank does not detect the forgery it cannot recover the loss from its customer.[54] As with the negotiable instruments characterization, the contract could shift the placement of loss if it were found to override the letter of credit characterization.

If the factoring characterization is used, then the forged sales draft is equivalent to a forged contract of sale. Naturally, the factor cannot collect from the person whose name has been used fraudulently because the actual person is not indebted to the merchant and the factor is subject to those equities. If the factoring arrangement is of the recourse variety then the factor is able to recover the loss from the merchant. This characterization is the closest one to the present credit card system with respect to liability between the merchant and the bank. However, it would prohibit the establishment of any liability on the customer, which is contrary to the cardholder agreement.

(b) <u>Possibility of Charge Back by the Customer</u>

The charge back is an essential area for the analysis of credit cards. The term generally describes the circumstances and the manner by which the value of purchases can be charged against the vendor as opposed to the purchaser or the financial intermediary. Its significance flows from the tactical or practical advantage in favour of a potential defendant created

by the cost to the plaintiff of litigation. Illustrations may be helpful. If A buys goods with cash, and they are defective, he must sue to recover his money or part of it. On the other hand, if A uses a cheque to pay for the goods he can stop payment on the cheque and force the vendor to sue him instead. The effort, expense and risk of litigation weigh in favour of the customer in that case, although it must be remembered that in litigation based on a stopped cheque, the actual burden of proof is on the defendant to prove that the goods were defective. To establish a prima facie case, the plaintiff need only show that a cheque was delivered and returned by his bank because of a stop payment. The ability of the customer to countermand a cheque (see section 167 of the Bills of Exchange Act) gives him the power to initiate a charge back. The final result being that the value of the cheque is debited from the merchant's account after he has been given provisional credit for it.

In the credit card system there is another form of charge back. It has the same end result, the merchant ending up with no consideration for the goods sold, but the initiation is not the same. The merchant bank agreement states that the bank may charge back the value of drafts when, for example, the customer claims the goods are defective; i.e., when the customer refuses to pay the bank (note: nothing in the customer bank agreement tells the customer of this power). Note also however that the bank customer agreement says such disputes will be resolved between the customer and the merchant directly without involving the bank. This could mean that the bank could refuse to make a charge back and insist on payment. Thus, forcing the customer to sue the merchant for redress. Let us now consider how, if at all, a charge back would work in the various analogies already traced through for the subject of unauthorized use.

If the sales draft is characterized as a bill of exchange, the customer is drawee and acceptor and is primarily liable. To effect a charge back this liability must be shifted to the merchant drawer. This can be done through the mechanism of dishonour. When the bank presents the bill to the drawee customer for payment, he can refuse to pay and this renders the drawer liable to indemnify the bank; i.e., to pay back the money it paid out on the bill. Of course the merchant has a remedy against the customer subject to whatever equities may exist between them but this is not consistent with the principle of charge back described above which merely alters the tactical positions of the parties not their ultimate liability. It appears therefore that the bill of exchange characterization would result in a charge back arrangement which is consistent with the contractual arrangement. On the other hand the specialized forms of bills of exchange of cheques and promissory notes would not result in the same conclusions.

If the sales draft is characterized as a letter of credit than the value of a draft drawn on the letter of credit must be charged to the vendor of goods not to the bank customer as would otherwise be the case. In other words, the beneficiary of the letter of credit, having tendered the letter of credit to a vendor as payment of goods must be able to stop the bank from paying the vendor's draft on that letter. This appears to be possible in two rather complicated ways. The situation is described very clearly in the following passages from page 56 of Gutteridge and Megrah, The Law of Bankers Commercial Credit.

Restraint of Payment

In view of the banker's obligation under an irrevocable credit to pay, his buyer-customer cannot instruct him not to pay. In *Hamzeh Malas* v. *British Imex Industries Ltd.*,[18] the plaintiffs, the buyers, applied for an injunction restraining the sellers, the defendants, from drawing under the credit established by the buyer's bankers. This was refused, JENKINS, L.J., stating, at p. 129, that

> . . . the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods which imposes on the banker an absolute obligation to pay. . . .

and that this was not a case in which the Court ought to exercise its discretion and grant the injunction. SELLERS, L.J., said that there might well be cases in which the courts would exercise jurisdiction, as 'where there is a fraudulent transaction'. This case was referred to by LORD DENNING, M.R., in *Elian & Another* v. *Matsas & Others*,[19] who agreed that a bank guarantee

> is very much like a letter of credit. The courts will do their utmost to enforce it according to its terms. They will not, in the ordinary course of things, interfere by way of injunction to prevent its due implementation. Thus they refused in *Malas* v. *British Imex Industries Ltd.* But that is not an absolute rule. Circumstances may arise such as to warrant interference by injunction.

And in the circumstances of that case the Court held the injunction justified. At the same time, the buyer could sometimes achieve the same end by making it impossible for the seller to comply with the terms of the credit. In many cases documents tendered may be irregular in some slight technical matter. Whether the irregularity is such that an issuing banker is justified in refusing to pay may be a difficult question. A buyer may even ask his banker to scrutinize documents with the object of finding fault. If the banker is in doubt as to the significance of an irregularity he should decline to pay; on the other hand, to refuse for an obvious mistake or for an irregularity which does not touch the contract fundamentally would destroy the value of irrevocable credits as a means of facilitating overseas trade; while literal compliance is essential, it is often impracticable.[20] The difficulty is often met by indemnifying the issuing bank.

[18] [1957] 2 Lloyd's Rep. 549; 1958 2 Q.B. 127; see also *Société Metallurgique d'Aubrives & Villerupt* v. *British Bank for Foreign Trade* (1922) 11 Ll.L.r. 168, in which, on orders from the buyers, the bank refused to pay; the documents tendered being in order it was held that they could not refuse; see also *Contronic Distributors Pty. Ltd.* v. *Bank of New South Wales and others* [1975] (New South Wales Supreme Court).

[19] [1966] 2 Lloyd's Rep. 495.

The foregoing quotation demonstrates that it is possible to have a charge back using the characterization of a letter of credit. However, the mechanism is complex and therefore expensive and is not one which is very beneficial to any of the three parties to the transaction. Accordingly, if the proper characterization of sales drafts is that of a letter of credit then the power of the bank to effect a charge back is in general terms inconsistent with the essence of that characterization. Once again, one is thrown back to the determination of whether the contractual provisions take precedence over the proper characterization.

In discussing the sales draft characterization of factoring only recourse factoring will be discussed. The very nature of non-recourse factoring prevents any charge back being made.

The parallels between the credit card charge back and recourse factoring are striking. In both cases the mechanism is defined by an agreement between the merchant and the financial institution and is triggered by the customer refusing to pay. The result is that a transaction which would normally effect a credit for the merchant with the financial institution has the choice whether to charge back or take recourse and the merchant can take action against the customer if that is done. In the analogies to negotiable instruments where liability is fixed by the rules of that body of law and then shifted by the credit card contract, the law of negotiable instruments and contract must be integrated. In the factoring analogy there is no such conflict as it is purely a contractual relationship.

(c) Customer's Remedy for Defective Goods

In the credit card scheme a customer who finds

that his merchandise is defective can go to the merchant and attempt to negotiate for a credit subject to the ordinary rules of commercial law. If successful a credit draft is sent through the system and is feflected in the descriptive billing. If the customer is unsuccessful he can refuse to pay but he must notify the issuer of this otherwise he will simply be charged interest on the unpaid amount of his monthly bill. Then the bank may or may not charge back the draft. If they do not, they will insist on payment and the cardholder bank agreement attempts to eliminate the customer's defences based on the equities between him and the merchant. Recall it states all disputes are to be resolved directly between the merchant and the customer. Again we must examine whether the various characterizations would cause different legal results than the contractual provisions.

The magic of negotiable instruments is that third parties take them free of the equities between the original parties. This enables holders in due course to re-exchange them for value over and over which is the essence of negotiability. In the context of this work if a sales draft is a bill of exchange payable to the bank then the bank is a holder but not a holder in due course. Holders are subject to the equities between the drawer and the drawee.[55] Accordingly, if the drawee (customer) in equity owes nothing to the drawer (merchant) because, for example, the goods exchanged between them amounted to a total failure of consideration, then the customer would have a defence against the holder (bank), but not against a holder in due course. The result, therefore, is the exact opposite of the contractual provision.

If the beneficiary used a letter of credit to purchase goods which turned out to be defective, he would like to avoid paying the bank the value of the draft. As letters of credit are creatures of contract it is up to the parties to

determine on what terms the customer will repay his bank. As the bank's right of action against its customer is based on contract alone and not on the assumption of any pre-existing obligation (which might have equities attached) it is inconceivable that the bank would make itself subject to defences which the customer could raise against the merchant vendor. The position of Midland Bank Limited is made clear in the following clause taken from the back of its letter of credit application form.

Responsibility of Bank

It should be clearly understood that the Bank is not directly concerned with the proper fulfilment of the contract between the seller and the buyer. Its duty is simply to receive documents on behalf of the customer which purport to comply with the conditions stated when opening the credit.

The Bank has the right to realise the goods or to take any steps, at its discretion, with a view to safeguarding its position.

The actual letter of credit agreement has the following clause:

> "The Bank is not to be responsible for any loss or damage to the merchandise, however caused, nor in the event of any misdescription, misrepresentation, mistake, error or irregularity as to the merchandise or the quantity, quality, nature, size or value thereof, or in the drafts or other documents, nor for the terms, conditions or sufficiency in any respect of the Insurance, nor for the default of the underwriters."

It is submitted that in the letter of credit characterization the customer has no defences to an action for payment by the issuing financial institution and that this situation is identical with the one created by the credit card contract.

If the credit card system is in actuality a variant of credit factoring which is governed by the laws of assignment, then the customer could have his defences against the factor

in an action for payment. This is so because an assignee can be in no better position than his assignor, a proposition which has been codified in section 54 of the Conveyancing and Law of Property Act. This is the exact opposite of the contractual provisions although the common law can always be varied by contract.

The neat thing about the equities between the purchaser and the vendor is that they flow both ways. Thus, a clause in the agreement between them to the effect that the customer's defences would not be asserted against an assignee is binding on the customer. This, of course, is the infamous cut-off clause. In Ontario the Consumer Protection Act has limited the effect of the cut-off clause. Section 42(a) states that "the assignee of any rights has no greater rights than and is subject to the same obligations liabilities and duties as the assignor, and the provisions of this Act apply equally to such assignee." This section was aimed at the practise of assigning financing contracts made in connection with consumer purchases. Unfortunately, it does not apply to the credit card transaction. The section says, "the assignee of a lender... is in no better position...." "Lender" is defined in section 1(k) as a person who extends credit. "Credit" is defined in section 1(e)(i) as "credit for which the borrower incurs a cost of borrowing and, given under an agreement between a seller and a buyer to purchase goods or services by which all or part of the purchase price is payable after the agreement is entered into." This does not apply to the assignment of the merchant's receivables because the merchant is not a lender. He does not charge for his "credit." "Lender" and "credit" are defined differently in other provinces, (see the section on statutes infra.) The cost of borrowing in a credit card system is paid to the bank. Moreover, the merchant agrees with the bank to accept the

credit cards on cash terms which would seem to rule out any service charge for the use of the credit card. Thus, it seems there would be no defences because that is what the contract stipulates. There is this difference however. The customer in the credit card system never agrees with the merchant not to assert his defences against the bank. This undertaking is given to the bank in the bank cardholder agreement.

The characterization of the sales draft as a factoring transaction would result in the bank being subject to the defences of the customer. However, the common law position can always be contracted out of and a cardholder agreement has done so. Therefore, the characterization of factoring would not result in a legal responsibility which is inconsistent with the contractual provisions between the bank and the cardholder.

(d) Conclusion

The credit card transaction can be characterized as a negotiable instrument, letter of credit or assignment of receivables. None of these characterizations is entirely satisfactory in describing the credit card transaction. This is because these devices have existed for a long time and have been used in a commercial context which had nothing to do with credit cards. It is a result of this problem that contractual relationships have been set up between the merchant and the bank and the cardholder and the bank. That raises the problem of which arrangement should take precedence. If the characterizations take precedence over the contractual provisions different legal results can occur than are contained in the contractual provisions. Furthermore, the legal results vary depending upon which characterization is applied. On the subject of liability for unauthorized use the characterization which is closest to the contractual provisions is that of factoring. However,on the subject of charge backs the

characterization which is closest to the contractual provisions is that of bills of exchange although factoring provides a reasonable equivalent. On the other hand, when the question of defences for defective goods is examined the characterization which closest resembles the contractual provisions is that of a letter of credit.

What the above analysis demonstrates is that there are no clearly decided rules concerning the law of credit cards. The parties attempt to provide the law in part by the provisions in their contracts. However, all of the parties run the risks of the courts applying characterizations relating to traditional notions of commercial law. Such characterizations may result in different liabilities arising than those described in the contractual provisions. Furthermore, when one examines the possible alternative kinds of characterizations it can be seen that the jurisdiction to legislate can be shifted from one level of government to the other depending upon the characterization which is utilized. If there is to be certainly for all parties there is a need to legislate. If a law of credit cards is to emerge which is satisfactory, taking into account and balancing the interests of all the parties involved, then it is clear that legislative action is the only way which that will come about. The development of such legislation is necessary and it is apart from any developments which may be occurring as a result of electronic payments systems. The next part of the paper examines the existing federal and provincial laws which relate to credit cards with a view to demonstrating the inadequacy of the present legal regime concerning credit cards. After a brief discussion of the constitutional powers the last part of the paper outlines matters which must be taken account of with respect to electronic payments system developments.

(IV) PRESENT FEDERAL/PROVINCIAL LAWS RELATING TO TRANSACTION CARDS:

At the present time there are no debit cards in use in Canada and accordingly there is no legislation directly related to debit cards. There is some legislation which does relate to credit cards and this section is intended to draw to the reader's attention those statutes which may touch upon the credit card transaction.

(i) Federal Statutes

As was pointed out in the section under the current legal status of transaction cards, there are a number of possible characterizations which can be placed upon this credit card transaction. If the appropriate characterization is that of a negotiable instrument then the federal Bills of Exchange Act would have application to credit cards. As was pointed out previously that characterization is not entirely suitable for a credit card transaction, however, it may have that location.

There is no other federal legislation which has direct application to credit cards. The Small Loans Act specifically exempts Canadian chartered banks from its application. Otherwise it would regulate interest rates chargeable in respect of credit card accounts. At the present time banks directly operate their credit card transactions and merely license the logos which they use from Master Charge or Visa. Therefore, credit is being granted by the bank and the Act has no application.

Even the Bank Act has very little applications to credit cards. Section 92 of the Act and the regulations thereunder (SOR 67/504) deal with the disclosure of the cost of borrowing. Those disclosure requirements would apply to the

setting up of the credit card contract with the cardholder. There are no other federal acts which affect the credit card transaction.

(ii) Provincial Laws

In Ontario there is only slightly more law affecting credit cards than there is within the federal jurisdiction. The principal act affecting credit cards is the Consumer Protection Act. Section 36 of that statute requires that the cost of borrowing be disclosed when goods are purchased generally under a purchase money security interest arrangement. That section has no direct application to credit cards because the definition of "credit" in the statute defines it as credit for which the borrower incurs a cost of borrowing. At the time of the transaction the borrower does not incur a cost of borrowing and would only do so if he does not pay the bank once he receives the statement. Accordingly, at the present time section 36 does not apply to credit cards. However, a modification of the definition could make that section apply. If that were done the effect would be to require a disclosure of interest rates every time a consumer used his credit card to purchase goods or services.

Section 37 of the Consumer Protection Act regulates what the statute defines as "variable credit." Section 37 is clearly directed at requiring the disclosure of the cost of borrowing at the time that a credit card is acquired from the card issuer. However, the statute restricts the section to applying to "lenders." It is highly debatable whether a credit card such as the one used by the major chartered banks falls within the definition of "credit" in the statute. This is principally because the credit has to be given under an agreement between a seller and a buyer and of course there is no such agreement concerning credit. In any event the banks

take the position that their disclosure requirements stem from the Bank Act discussed above and that they are not subject to any disclosure requirements set out in section 37 and the accompanying regulations to the Consumer Protection Act.

As was discussed under the various characterizations of credit card transactions, section 42 of the act eliminates cut-off clauses. If the characterization of credit cards involves an assignment then of course this section would come into play to make the banks subject to the equities which may exist between the original parties to the transaction in which the credit card was used.

Therefore, although all of sections 36, 37 and 42(a) have a potential to affect credit cards, they do not do so at the present time, at least in a clear and direct fashion. The only other section of the statute which does clearly affect credit cards is section 46. That section is directed at the problem of liability for unsolicited cards. The effect of this section has been to largely eliminate the practice of mailing unsolicited credit cards. In spite of its apparent effectiveness there is clearly a gaping hole in the section. The section does not prohibit the mailing of an unsolicited credit card and furthermore indicates that if the credit card is used, the user will be liable for its use. Therefore, the section has a very narrow basis. All the section accomplishes is that it prevents an action being brought against a person who was mailed an unsolicited credit card but never used that card.

As was pointed out under the discussion of the characterization of the credit card transaction as an assignment of receivables, section 54 of the Conveyancing of Law Property Act would require notice of the assignment from the merchant to

the bank. However, again this section is not directly aimed at credit cards although it may have some application to them. Other than these sections of the Consumer Protection Act and this statute there are no others which have a direct or indirect effect on credit cards.

The other provinces of Canada have statutory provisions similar to that of Ontario relating to the disclosure of the cost of borrowing. Each province has some variation in formulas used to establish the borrowing figures. Furthermore, the arguments concerning the probable lack of effect of these sections on bank credit cards seems to have equal application to the other provinces' legislation. Unlike Ontario, Alberta, Manitoba, New Brunswick and Prince Edward Island completely prohibit the distribution of unsolicited cards. There is a varying standard in the provinces concerning whether or not use of the unsolicited card is deemed to the acceptance. For example, the British Columbia Consumer Protection Act provides that mere use of an unsolicited card is not statutorily deemed to be acceptance and requires that there be acceptance in writing.

The only additional legislation in other provinces which directly affects credit cards and which have no parallel in Ontario appear to be provisions limiting the liability for the unauthorized use of a lost or stolen card. Alberta, in its Credit and Loan Agreements Amendment Act (No. 2) S.A. 1972 c. 104 s.8 enacting section 15.21 limits liability for unauthorized use of lost cards before notice to the card issuer to $50.00. The Manitoba Consumer Protection Act RSM, 1970, c.200/ as amended by S.M. 1971 c.36/S.M. 1973 c.51 in section 116(2) provides for a similar limit of liability for unauthorized use prior to notice. Other than these two provinces there does not appear to be any province which has legislation which directly affects credit cards which is not present in

Ontario law.

(iii) Conclusion

As can be seen from the foregoing description there is very little legislation which directly affects credit cards in Canada. Apparently, no government has felt that the subject matter is sufficiently important to have required legislative enactment. The introduction of a further transaction card in the form of a debit card in the near future is going to increase the uncertainties surrounding transaction cards and their use and the resultant legal rights and responsibilities. It is, therefore, urged that the province consider legislation which attempts to define credit cards and sort out the roles and responsibilities of the parties to transaction card transactions. There have been absolutely no reported court decisions concerning credit cards in Canada. As has been suggested in the Economic Council of Canada report [56] this is probably because as a marketing strategy card issuers are not pursuing their legal rights. Undoubtedly, cards are becoming sufficiently widely accepted that card issuers are more likely to stand on their legal rights in the future. The need for protective legislation before this occurs is obvious. The financial institutions need the certainty of an adequate legal regime governing transaction cards. The other two participants in transactions, the merchant and the customer/cardholder, also need their rights and responsibilities defined in order to obtain certainty and greater protection than they now have. This paper has not been commissioned with the view to making concrete and specific recommendations concerning what legislation should be put in place with respect to credit cards. It is therefore outside of the scope of this paper to go any further with these suggestions. However, as this paper is ultimately directed at electronic funds transfer problems with transaction cards, these matters should be taken into account in drafting legislation affecting transaction cards as they are

currently being used. In this connection it is useful to have a brief discussion on the constitutional powers before moving to an examination of the transaction card related issues evolving out of electronic funds transfer.

(V) CONSTITUTIONAL DIVISION OF LEGISLATIVE POWERS

As an element of electronic funds transfer and also therefore of an electronic payments system, the subject of bank cards touches every one of the subject headings under which EFT is being analyzed, including in general terms, communications technology, monetary policy, competition, the administration of justice and consumer protection.

This material will be concerned primarily with the constitutionality of legislative enactments relating to bank cards as a mode of payment, and as an extension of credit. Other aspects of bank cards will not be discussed although they may be referred to peripherally.

The legislative powers of the federal and provincial governments are of course as they are set out in the British North America Act, primarily ss. 91 and 92, and, as that statute has been interpreted by the judiciary. There are obviously no express provisions in either section for legislation in respect of "credit cards," "the payments system" or "the extension of credit." The determination of legislative competency over bank cards therefore reduces to "a consideration of which of the enumerated heads of s.91 or 92 the problem is more clearly in relation to."[57]

The enumerated heads under which the credit and payment aspects of bank cards could fall are as follows:

Federal

1. 91(15) Banking
2. 91(18) Bills of Exchange and Promissory Notes
3. 91(19) Interest
4. 91(14) Currency and Coinage
5. 91(20) Legal Tender

Provincial

1. 92(11) Property and Civil Rights in the Province
2. 92(16) Matters of a Local or Private Nature
3. 92(10) Local Works and Undertakings
4. 92(14) The Administration of Justice

PART I Provincial Jurisdiction:

What follows is an exposition of how the province could employ its powers to regulate the credit and payment aspects of bank cards.

As B. Welling pointed out in his working paper, because the federal government holds the residue of power, it would seem logical to commence the determination of within whose competency a particular matter lies, by determining whether it falls within a provision of S.92. If it did then it would be a provincial matter, if it did not then it would be federal, by default. In fact the approach taken by our Courts is just the reverse. Welling describes it as follows:

> "The traditional approach has been to ascertain whether the subject falls within the federal enumerated heads, usually narrowly interpreted. If the matter did not fall squarely within the Federal Field, all its local, private, and intra-provincial aspects were normally held to fall within the provincial domain and to be immune from federal interference."

As it is concluded that there is ample authority for the province having legislative jurisdiction over cards it will not hurt to reverse the process described above and deal with the provincial heads first. In the end it will be seen how the federal banking power is in all instances the limit on the provincial competence in this matter.

Under the property and civil rights jurisdiction, provinces have the power to make laws protecting existing civil rights and to create new ones, with reciprocal civil obligations. Welling cites the regulation of liquor in the province as an example of this power. The regulation of commercial transactions by the Sale of Goods Act, the Consumer Protection Act and the Business Practices Act is another example of the exercise of this provincial power. To the extent that bank cards are matters of contract and private relationships between financial institutions, merchants, and consumers,[58] they would fall within the scope of the property and civil rights jurisdiction and the local and private nature jurisdiction. In addition, certain aspects of the credit element in card systems could fall under these heads of power. The Ontario Unconscionable Transactions Relief Act is another example of valid provincial legislation[59] which deals with certain aspects of credit granting. The significance of this observation will be more evident when the federal "interest" power is discussed.

The suggested statutory reforms which could be effected under these heads are as follows:

1. An arbitrary limit on liability for unauthorized use
2. Prohibition of unsolicited debit/credit cards
3. Mandatory descriptive billing
4. A provision for "stop payment" or charge back
5. Provisions re disclosure of interest rates in card advertising

6. Civil and quasi-criminal penalties for violation of card regulations
7. Preservation and Codification of customer defences
8. Prohibition against waiver of customer defences
9. A low dollar limit on charge backs
10. Issuer financed insurance for cardholder losses
11. Disclosure of loss shifting provisions
12. Civil liability (statutory damages) for damage resulting from the unsolicited card intercept
13. Prohibition of liability until notice for unauthorized use
14. Photographic identification on cards
15. Prohibition of discounts for use of EFT
16. Creation of a right to have an EFT debit card
17. Provision for equal EFT terms for all
18. Prohibition of set offs between EFT and other accounts

It should be noted that most of these reforms would affect the cardholder-bank contracts and as such would be private matters of property and civil rights. A fine example of a draft bill which could establish many of these reforms is to be had in United States Senator Riegle's Bill S.2546 which would add a title called "Electronic Fund Transfers" to the Consumer Credit Protection Act (U.S.C. 1601 et seq.). Many reforms similar to these were effected in the U.S. by The Fair Credit Billing Act of 1974 which amended that portion of the Consumer Credit Protection Act known as the Truth In Lending Act.

The jurisdiction of the province under the powers contained in ss. 92(16), (10), (11), and (9) is to a large degree jurisdiction over local matters. It has been concluded that the province need show no other justification for legislating regarding some installation or behaviour than to clearly establish that the matter is outside the federal

sphere and that the effects of the law will be entirely intra-provincial.[60] The "federal sphere" referred to above, in the context of cards, is of course the banking and "money" jurisdiction which is discussed below. Again, it is the limit on the provincial jurisdiction. Even so, the provincial power over local matters is extensive. Indeed F.J. Jordan has stated that a province could control all local businesses and operations with the following exceptions:

> "(a) aeronautics, radio and television operations,
>
> (b) local works declared federal under 92(10)c and
>
> (c) local works and undertakings that are functionally under federal jurisdiction, e.g. postal services, navigation and shipping."[61]

One wonders why banking is not included in subdivision (c) above for as Welling pointed out, "the scope of the federal banking and telecommunications powers must be considered in attempting to assert provincial control over any aspects of computer based financial intermediation."[62] Whatever the limit of the provincial power is it is clear that there is a substantial jurisdiction.

Under the head of "Administration of Justice..." the provincial government could reform the laws of evidence as required by the spread of EFT. The suggested reform to the effect that an EFT machine receipt be prima facie proof of payment (instead of a cancelled cheque) is an example of this. For a complete discussion of the evidentiary implications of EFT see the working paper produced by A. Bryant.

PART II Federal Jurisdiction

Under the heading of Provincial Jurisdiction, supra,

attention was focussed on the private and local aspects of the card systems. That is to say the validity of provincial jurisdiction was founded upon the assumption that card schemes were actually a form of "vendor credit" extended through the machinery of the factoring contracts. As we have seen however, the card systems can be characterized otherwise. The fact is therefore, that certain aspects of card systems may fall within the federal realm. It is largely a question of characterization.

The direct obligation characterizations, bills of exchange, promissory notes, and to a lesser degree letters of credit all involve lender credit and it is this aspect of the card systems which falls within federal jurisdiction. To review, S.91(15) is the Banking power, S.91(18) covers Bills and Notes, S.91(19) is Interest, 92(14) is Currency and 91(20) is Legal Tender. These are the powers which will be discussed. The federal jurisdiction over Telegraphs...92(10), and 91(27), the Criminal law power are ignored because they do not have any particular relevance to the bank card issues of credit and payment. They and other heads of federal jurisdiction over E.F.T. and E.P.S. are discussed fully in B. Welling's working paper on constitutional issues.[63]

S.91(15) Banking, The Banking Limit:

As a result of the approach taken by our courts, (described supra at p. 46) to the extent that card transactions are a banking function, provincial jurisdiction is excluded. There is no doubt whatsoever that banking is a matter for federal regulation; the debate is over the extent of the banking limit and it hinges on what is included in "Banking."

Banking has been defined broadly, so as to include matters relating to "money", with the result that "banking was held to be wide enough to embrace every transaction coming within

the legitimate business of a banker."[64] This approach to banking was extended in Reference Re Alberta Statutes [1938] S.C.R. 100 so that federal banking power could encompass virtually any form of financial intermediation over which parliament chose to legislate.[65] However, B. Welling has concluded that a narrower definition of banking may be appropriate because the B.N.A. Act may not require that banking and "money" be indivisible. He argues that a narrow view of "banking" reasonably explains why a provincial financial institution, was found not to be carrying on "banking" in Re Bergethaler Waisenamt [1949] 1 D.L.R. 769, and why provincial legislation which affects financial intermediation has not been challenged. However, it appears that legislative forebearance, for political reasons, on the part of the Federal Government is an equally plausible explanation of why provincial financial institutions have not come under federal regulation. The narrow interpretation of banking jurisdiction takes its vitality from the "aspect" doctrine of Canadian constitutional law. It is because of this doctrine that a statute which in effect, regulates an element of banking is not necessarily a law in relation to banking.[66]

As a result of the aspect doctrine, both branches of government can enact valid legislation which affects banking so long as the particular aspect of the subject which the law relates to is within the legislative jurisdiction of the particular government. The federal Investment Companies Act is an example of how the federal government apparently respects provincial jurisdiction over certain aspects of financial intermediation. P.N. McDonald stated,

> "In enacting the Investment Companies Act, Parliament acted on the assumption that its banking power was not broad enough to encompass all intermediaries. In 1966 the Inspector General of Banks said that Atlantic Acceptance Corporation

> did not carry on a business that could have been described as banking: "They were not normally in short term borrowing. They did not carry on a chequing business."[67]

McDonald's remarks are a reference to the fact that the Investment Companies Act applies only to federally incorporated companies. As the example cited, Atlantic Acceptance, was a provincial corporation it was not subject to the Act.

Consistent with the lack of federal jurisdiction over private and local aspects of financial intermediation are the provincial statutes in that regard. The Credit Union and Caisse Populaires Act, and the Loan and Trust Companies Act of Ontario are examples. However, this consistency should not be seen as evidence of the constitutional validity of the legislation or of the activity of the Credit Unions and Trust Companies. Indeed as was said above, it may be the case that the federal government has jurisdiction over such activities and is just not exercising it. Welling declined to make a conclusion on whether the inaction was due to a narrower conception of banking, or political reticence, but he did make the following statement.[68]

> "Clearly, the failure of Parliament to subsume all "near-banks" into the chartered banking system is, on this basis, a simple failure to occupy the banking field. However, the longer the present system continues, the more politically difficult it is likely to become to bring all such institutions under the Bank Act."

It is concluded that the banking jurisdiction of the federal government represents the real limit on the provincial power to regulate transaction cards, however, there are two other areas of federal control which could also have a restrictive

effect: The "money" jurisdiction and the interest power.

There is no express "money" jurisdiction. The authority in this field is collected in S.91(18) - Bills and Notes, S.91(14) - Currency and Coinage, and S.91(20) - Legal tender. The latter two enumerated heads are far too particular to be of any constitutional significance in the early development of EFT. The Bills and Notes jurisdiction has obvious relevance to card systems if the characterization of cards as bill, or notes is accepted. Indeed, it is difficult to see how there could be any provincial regulation of the card drafts if those characterizations prevail.

The Interest jurisdiction of the federal government would seem to have direct application to the credit aspects of the card systems, however this is not entirely the case. Formerly "interest" had the broad meaning of a fee for the use of funds.[70] More recently however, the definition has been narrowed, as in the case of A.G. Ontario v. Barfried Enterprises Ltd. [1963] SCR 570, so that it now means "a charge whose amount accrues over time." This narrow definition resulted in the Unconscionable Transactions Act of Ontario, which gives a Court power to revise certain financial transactions, such as mortgage loans, where the cost of the loan is excessive, being found to be intra vires the province. The Supreme Court of Canada said that the legislation was in relation to property and civil rights and only incidentally affected the subject matter of S.91(19) of the B.N.A. Act, interest. Obviously, if this approach to the question of interest is continued then the provinces may continue to regulate incidental matters affecting interest, such as, disclosure of rates, debt adjustment, and business practices involved in credit granting.

Conclusion:

There is ample jurisdiction vested in the province to

regulate all private and local aspects of card transactions and this power will be defined by the extent of the federal jurisdiction over banking, interest and bills of exchange, as interpreted by the courts.

(VI) TRANSACTION CARD RELATED ISSUES ARISING OUT OF ELECTRONIC FUNDS TRANSFER

A. LIMITATION ON CARDHOLDER LIABILITY

The present payment system for cheques assigns rights and liabilities between depository institutions and their customers by statute.[71] That statute allocates the risk and liabilities on an all or nothing basis for matters such as fraud, forgery and theft.

The present card system is a matter of private contract. As has been demonstrated[72] the depository institution tends to assign rights and liabilities to the other two parties in the relationship by specific contractual provisions. The depository institution is able to allocate the risks in its contracts because of its powerful bargaining position. The result has been that the interests of the depository institution have been placed ahead of those of the cardholder.

In an EFT environment the transaction card will, in conjunction with unique identifying codes commonly known as personal identification numbers (PINS), be the access to the EFT service. This makes the transaction card different than the present credit card and chequing systems in that the mechanism for authorizing use is in the control of the cardholder, not the depository institution. The result is that the balance between the protection of the individual cardholder and that of sound banking practises must be reassessed. This should be done

by first examining the balancing of interests within the current cheque and credit card systems and then describing the differences in the EFT environment which may require a re-ordering of the balance. Finally, specific recommendations are made taking these new EFT factors into account.

(i) Unauthorized Use of Requested Transaction Cards

In the chequing system the bank is generally responsible for identifying who has ordered it to pay.[73] Furthermore, it is liable to the customer for payments made pursuant to an unauthorized cheque. The present contractual provisions for credit cards provide that the cardholder is liable for unauthorized use until the bank is notified in writing or the unauthorized amount owing exceeds $50.00.[74]

The evolution of credit cards into transaction cards in an EFT environment will require the use of some sort of personal identification number (PIN number). That number will be within the responsibility and control of the cardholder and will be used to activate the system.

The primary problem with the present $50.00 contractual limit when applied to EFT cards is that it would always result in a $50.00 payment by the cardholder. The present rule encourages the cardholder to send his notification of loss as soon as possible to escape, if possible, the limited liability of $50.00. In an EFT environment a fraudulent user can have the appearance of authorization if he is in possession of the card and the PIN. Furthermore, none of the present hurdles to unauthorized use inherent in the requirement of signatures and face to face dealings will be present in an EFT environment. Their absence is likely to increase fraudulent use. The result would be that a $50.00 limited liability rule would be likely to always result in the cardholder paying the first $50.00

of loss in an EFT environment. There would be, therefore, less incentive to report the loss than with the present credit cards.

A further problem with transaction cards in an EFT environment centres on the increased options to use the card to make cash withdrawals. The cards will have a debit function enabling the withdrawal of cash by activating an automatic teller machine. Whereas cash can only be obtained with a credit card by a face to face transaction over the bank counter. In an EFT environment there seems to be less reason why the cardholder should have limited liability regardless of his conduct. After all, he controls the authorization mechanism (PIN number) which in the present credit card system is within the control of the bank and for which the bank is liable. However, there is an obvious need to limit liability in order to encourage people to use transaction cards.

The balancing of the competing interests seems to focus on the conduct of the cardholder with respect to the PIN number. The card without the PIN is useless. It is the key to making each transaction appear as an authorized one. Unauthorized use could only occur because of the cardholder's care of the PIN number. If the cardholder through keeping the PIN number and card together or voluntarily giving the PIN and card to someone enabled an unauthorized transaction to occur, he should have the responsibility for liability.[75]

In all other cases notification to the depository institution within a specified time period should relieve the cardholder of all liability for unauthorized use.[76] This principle retains the incentive to notify. As was noted above the incentive may not be present in an EFT environment under a $50.00 limited liability provision. The principle also has the advantage of paralleling the present credit card provisions with respect to a duty being on the cardholder to notify the card issuer.

Failure to notify the depository institution within a specified time period should make the cardholder liable from the point of first unauthorized use until notification is given. If notification is never received by the depository institution then the cardholder would be liable for all unauthorized use.[77]

(ii) <u>Unauthorized Use of Unsolicited Transaction Cards</u>

As has been mentioned some provinces prohibit the distribution of unsolicited credit cards. These provincial laws should be extended to include debit cards. If they are not, debit cards will become an easy method of circumventing the present provisions.

The liability for use of unsolicited transaction cards should be placed upon the card issuer not the named cardholder. This is the converse of the proposition set out with respect to requested transaction cards. The depository institution caused the cards to be circulated thus enabling someone to gain control of the authorization mechanism. Therefore, they should be liable. The only time the depository institution should not be liable is after an unsolicited card has been used by the named cardholder. In these cases the liability regime should be the same as if the transaction card were requested.

B. <u>SETTING UP THE TRANSACTION CARD RELATIONSHIP</u>

(i) Disclosure of Information:

The present provincial legislation on disclosure applies to both lender credit and vendor credit. The only provision which could relate to credit cards is S.37 of the <u>Consumer Protection Act</u> dealing with "variable credit." The

banks as credit card issuers are probably not within the definition of "lender" and the card transactions may not be within the definition of "credit."[78] In any event the banks take the position that such provincial legislation does not apply to banks and their credit card operations. The Bank Act has a general disclosure provision but it does not directly apply to credit cards. The proposed Bank Act has not changed that provision in any respect.[79]

Transaction cards in an EFT environment will require more disclosure than the traditional interest rate and cost of borrowing information which is presently disclosed under federal and provincial law. The potential cardholder must have certain vital information if he is to make a meaningful choice between credit and debit cards and other services offered by a depository institution. The limitation of liability concept described above must be disclosed in a clear and cogent fashion.[80] Cardholders must clearly understand their duties of reporting unauthorized use. The cardholder also needs to have an understanding of how the card will operate and how errors can be corrected. The cost of using the transaction card and the cost of borrowing must also be disclosed if the information for the cardholder is to be complete.

In the United States the Consumer Credit Protection Act,[81] requires the disclosure of a great deal of specified information regarding credit. The Truth in Lending Act[82] which is part of that statute deals with disclosure of finance charges in dollar and percentage terms in a fashion which is similar to Sections 36 and 37 of the Ontario Consumer Protection Act. The Truth in Lending Act and Fair Credit Billing Act[83] go much further in requiring disclosure with respect to credit cards. Senator Riegle's bill[84] requires disclosure in respect of EFT accounts. That proposed legislation requires disclosure of "all terms and conditions

governing electronic fund transfers involving the consumer's account."

The statutorily designated disclosures include liability for unauthorized use; name and number of person to be notified in event of unauthorized use; limitations in the agreement on the dollar amount of transactions; charges for use of the account; rights and procedure for stop payment; rights to reverse transactions; summary of error resolution provisions and the circumstances under which the financial institution will disclose information concerning the consumer's account to third persons.

It is recommended that the Consumer Protection Act be amended to include transaction cards. Those amendments should embody a disclosure requirement that requires a clear and meaningful explanation of all statutory and contractual rights and obligations particularly for liability for unauthorized use and error correction as well as costs for utilizing the transaction system and costs of credit. Furthermore, if a particular card is capable of being used as both a debit and credit card then a detailed explanation of how and when switchovers occur from one function to the other should also be part of the obligatory disclosures.

Disclosure at the time of entering the card relationship should not be the only disclosure required. The Consumer Protection Act (CPA) presently requires, in S.41, the disclosure of the annual percentage rate in all advertisements if the availability of credit is referred to in any manner. That section draws a distinction between "a charge for credit" and a "term of credit" in its disclosure requirement. Some studies indicate that where such requirements are imposed advertisers simply omit in their advertisements any mention of credit.[85]

Credit and other charges for transaction cards are a vital element of the competition between card issuers and the information upon which potential cardholders are likely to make a decision to utilize a service. Disclosure of annual percentage rates and other transaction card service costs should be required regardless of whether the advertisement mentions credit. It is recommended that for EFT transaction cards the distinction in S.41 of the CPA be abolished and that the section cover the disclosure of rate and service information in all advertising concerning transaction cards.

(ii) Statutory preservation of choice

The present credit card contracts between the issuers and merchants require that there be no discount offered by the merchant for paying in cash. This type of provision represents a form of economic coercion that is designed to force consumers to become credit card users. Banks and other depository institutions will have an even greater incentive to pressure merchants and consumers to utilize transaction cards and other EFT systems. It is essential that consumers be permitted to preserve their right to choose the method of payment.

Section 167 of the Consumer Credit Protection Act in the United States prevents any provision in a credit card contract from prohibiting the use of cash discounts. The present practice in Canada is to have a clause in the merchant agreement which prohibits cash discounts by the merchant. The American legislation goes further toward preventing coercion in that Section 168 even prohibits a financial institution from requiring the merchant to maintain an account for card transactions with it. Again the Canadian practice is the converse of the American statutory prohibition as the merchant agreements require the maintenance of such an account. The Riegle bill in Section 907 requires the same provisions with respect to credit extension in EFT use and prevents the compulsory acceptance of an electronic transfer.

The Law Reform Commission of Canada has recommended that the right of choice be protected with respect to credit clearing facilities which are utilized for automatic payroll depositing and other regular payments.[86] It suggests that with respect to automatic payroll deposits the consent be one which the consumer must actively not passively trigger and carry with it a right of revokation on notice.[87]

Ralph Nader in his model EFT Code suggests in section VIII a broader protection of choice by prohibiting the use of discounts for EFT use to provide an incentive to use EFT services rather than other modes of payment.[88] The final report of the United States National Commission on EFT advocates that EFT services should be used as a means of expanding consumer choices among financial services. It recommends that consumer choice be preserved by prohibiting attempts to restrict the choice of payment alternatives. However, it did not go as far as Mr. Nader advocates in connection with consumer choice of payment alternatives when making purchases. It advocates that payment alternatives in purchases are desirable but argues that there should be no limitation on merchants with respect to limiting payment to a particular mode. It is suggested that this is necessary because merchants may have legitimate business reasons for refusing to utilize a particular payment mode. The example was, that for security reasons, an all night gas station may not wish to receive cash.

Although the later part of the National Commission's recommendations are acceptable as a policy position in Canada, they do not entirely take account of the Canadian marketplace. As was indicated at the outset of this paper, the banks have used economic coercion to force the development of credit cards. In the future such power should not be permitted to be utilized to favour the development of a particular mode of payment, e.g. transaction cards.

Consumers cannot retain their choice among payment alternatives if they must elect to opt out of utilization of a particular payment mechanism.[89] As a matter of policy the United States Commission is correct in recommending that merchants not be restricted in terms of the payment mechanisms they will accept. However, as has been pointed out, the enormous economic power of the Canadian Chartered Banks has been used to advantage in the development of credit cards. A provision prohibiting cash discounts in the merchant agreements enhances the appeal of the credit card as a mode of payment. After all, the consumer has potentially 45 days of "free" credit before he must pay interest or the account balance. Such economic coercion should not be permitted in order to facilitate the development of EFT transaction card services. EFT should expand the consumer's payment alternatives not diminish them. The best mechanism for ensuring this would be a prohibition on limiting consumer alternatives in the cardholder contracts. Such a prohibition would have to encompass both direct limitations, and indirect limitations in the form of restrictions on the acceptor's right to offer incentives, such as discounts for the use of any particular mode of payment. Such a provision would prevent the merchant from being a conduit for the economic coercion which the issuer attempts to exercise in the contract, while leaving him free to make appropriate and competitive business decisions.

(iii) Rights of Access of Low Income Consumers:

Transaction cards and other EFT services are going to be available only to those individuals who have accounts with depository institutions. At the present time there are many Canadians who do not maintain an account with a depository institution.

There have been a number of studies in the United States concerning the inability of low-income consumers to rate shop for the best credit terms. Such studies indicate that low-income

consumers tend to pay more for consumer purchases.[90]

Testimony of consumer groups before the United States National Commission indicated that it was feared that the exclusion of low-income consumers from participating in EFT systems would result in their having to continue to pay more for goods and services.[91] The low-income consumer never earns sufficient income to buy many goods for cash. The result is a continuous requirement for credit to make most purchases, including necessities. However, this type of consumer is not mobile and not able to explore the credit terms of shop keepers far from his neighbourhood.[92] The result is that his consumption of credit is based on limited information gained in a neighbourhood store. If the low-income consumer is excluded from access to EFT transaction cards he will continue to be forced to use more expensive payments methods, such as money orders, as well as paying high credit costs. Furthermore, these individuals have difficulty cashing any cheques they happen to receive.

The Economic Council of Canada has also recognized these dangers and recommended that the government give priority to formulating guidelines which would define the rights and liabilities of all payment system's participants.[93]

EFT transaction cards present an obvious opportunity to provide less costly and more convenient financial services to low-income consumers. However, it is highly unlikely that the largely conservative card issuers will be willing to take the necessary risks in servicing this segment of the population. The alternative is for government, in co-operation with card issuers, to provide certain financial considerations to induce them to ensure that low-income consumers are not involuntarily excluded from the benefits of EFT transaction cards.

The above recommendation is tied into the policy considerations regarding sharing of the EFT system. See topic "D"

of this paper for a discussion of that system. The traditional source of credit for low income consumers has been the non deposit taking financial institutions such as the consumer loan companies. This group of institutions are the logical ones to whom incentives to provide the benefits of EFT to low income consumers should be provided. However, they will only be able to do so if they are given access to the EFT system through the development of a universal transaction card. As a result the recommendation of providing incentives to financial institutions to provide EFT services to low income consumers is tied to the policy considerations of sharing.

C. OPERATION OF TRANSACTION CARDS

(i) Billing Statement

It is possible to envisage the day when a single account could be accessed by means of a cheque, debit card, telephone and pre-authorized payments. The EFT transaction card then becomes merely one form of access. Such multiple access will make billing statements crucially important to enable the cardholder/account holder to monitor his account activity and detect errors. This aspect of the working paper concentrates solely upon the transaction card mode of access.

The present credit card system utilizes what is known as descriptive billing in that the sales drafts are not returned with the statement. Each transaction is described in a detailed fashion on the statement.

Consumer research in the United States indicates that consumers place a high value in retaining cancelled cheques for proof of payment, income tax and other purposes.[94] It is assumed that such attitudes are likely to be identical in Canada. Furthermore, as more transactions are made by transaction cards this attitude is likely to transfer to the billing

statements. It, therefore, follows that cardholders should be entitled to receive information similar to that which could be obtained from the use of a cheque.

The implementation of such a principle would ensure that present consumer interests are taken account of as well as contributing to the solution of certain evidentiary problems.[95] The implementation of the principle would require something to replace the cancelled cheque. The best way to accomplish this is to require that every time a transaction card is utilized, a receipt similar to the present credit card sales draft should be printed and available to the cardholder. This principle should apply to all transactions even in the case of terminals dispensing cash through the use of a transaction card insert.

The application of the principle would also require the regular mailing of a billing statement. However, if no EFT transaction occurred within a month no statement need be mailed to the cardholder. Section 906 of Senator Riegle's bill[96] requires much written documentation and stipulates what it must contain. It further provides in subsection (e) that such documentation is prima facie proof of transfers which it purports to record.

The billing statement should also describe the nature of the transaction, i.e., the purchase, cash withdrawal etc. as it will probably cover more than mere EFT transactions. The present credit card system does not need to do this. However, with the advent of transaction cards it will be required. The present practice with credit cards of describing certain card acceptors by numbers or names other than the trade name under which the cardholder would recognize the transaction should be eliminated. This will require legislation requiring the name used by the actual card acceptor to be the description of the actual party to the transaction on the billing statement. Section

127 of the American Consumer Credit Protection Act[97] regulates the issuing and contents of descriptive billing statements for credit card accounts, however, it requires only that the goods or services be identified, not the vendor.

(ii) Error Correction

In any kind of payments system there are a number of different types of errors which can occur. For convenience these errors can be grouped into four classifications stemming from who caused the error. Errors can be caused by the parties; the financial institution; an unauthorized user or in cases involving mechanism systems by the operational failure of the system. The resolution of these different types of errors in the present chequing and credit card schemes is examined first in order to identify how the resolution of errors may have to be altered in an EFT environment.

The present chequing system does nothing to correct errors made by the parties. For example, if the cheque is payable to the wrong payee or for the wrong amount there is no correction method available to the payor once the cheque has been cleared back to the payor's account. Prior to that the remedy of stop payment is available.

Bank errors involving cheques are governed by the account contract with the payor. The bank may have charged an account with the wrong item or amount or made computational mistakes. In these situations the bank takes whatever corrective action it deems appropriate. If it denies the existence of an error then the burden is on the customer to establish that there has been an error.

Errors caused by unauthorized use of cheques involve the question of forgery. The bank is required to prove that the signature was not a forgery or that the cheque was not altered.

Therefore, the burden is on the financial institution.

The cheque per se as a method of payment does not involve any mechanical processes. Therefore, there are no rules for correcting errors caused by a mechanical system. However, the process of collecting a cheque does involve the utilization of electronic data processing. If an error is caused by the data processing system it would probably be the liability of the payor. This statement can only be expressed as a probability because the antiquated rules of the Bills of Exchange Act were written without regard to the present collection process. Although most consumers probably consider an obligation as having been met upon delivery a cheque to the creditor there is in fact no payment until there is an actual appropriation of money by the bank.[98] Therefore, the risks of any errors created by the data processing system utilized in the collection process are likely to be on the payor[99]/drawer of the cheque.

The credit card system uses the rules of the chequing system as a basis from which to obtain its rules concerning error resolution. The primary difference is that the credit card rules being ones created by private contract go much further in isolating the card issuer from liability for errors and responsibility for their correction. No doubt this is because the rules are created by private contract which is unfettered by statutory rules or judicial decision. These latter two factors have undoubtedly resulted in the banks having greater liability and responsibility in the chequing system than would they have had if they had drafted all the rules as they did for credit cards.

The cardholder and merchant agreements both require party errors to be settled directly between the parties. For example, the correction of adding mistakes on the sales voucher, the wrong application of sales tax, the wrong price etc. all must be

corrected by the parties without the bank's involvement. Once a sales voucher has been processed the only mechanism for correction which the cardholder has is to get the merchant to issue a credit voucher. This can only be done with the merchant's assistance and co-operation. However, the merchant is in a more favourable position in that he can correct carbon copies before processing or issue a new sales voucher. Such a method of correction is not sanctioned by the legal arrangement but nevertheless the power of the merchant to utilize the opportunity is there and is used.

The correction of errors caused by the parties has changed to the cardholder's detriment from what the drawer/payor's position is in the chequing system. An error created by the parties can always be corrected by the payor, stopping payment in the chequing sustem. The payor's power to correct errors is greatly reduced with credit cards because there are no stop payment or charge back rights. The only right the cardholder has is to obtain the merchant's co-operation to correct the error. The merchant's right is similar save for the fact that he does have the power to correct errors by altering copies of the sales voucher before depositing them.

Bank errors in key punching data or other compilation errors can be corrected in a fashion similar to that available for cheques. The cardholder must appeal to the bank for the correction to be made. If the error is denied as with cheques the burden is upon the cardholder to establish the error.

Errors which are caused by the data processing system leave the cardholder in a somewhat improved position over that of the drawer of a cheque. The improvement lies in the fact that no differentiation of these types of errors from other types of bank errors is made. The result is that the liability for errors and responsibility for correction is initially upon the bank, not the cardholder, as would be the case with the drawer

of the cheque.

The consequences of unauthorized use are markedly different for credit cards than in the chequing systems. The cardholder is liable for the first $50.00 of unauthorized use of the card unless he has notified the bank of the card's loss before it has been improperly used. This again represents a diminishing of the cardholder's position concerning protection from errors caused by unauthorized use in the chequing system. The bank's burden involving unauthorized use of cheques is relieved in the credit card system to the extent it can charge the cardholder the first $50.00 of such use.

The reduction in the position cardholders found themselves in with respect to error resolution caused by the parties; card issuers; unauthorized users and errors created by the data processing systems has resulted in legislative action having been taken in the United States. The Fair Credit Billing Act[100] recognizes the deterioration in the cardholder's position with respect to error resolution and provides a formal procedure for resolving credit card disputes. There is no equivalent legislation in Canada. It's absence results in the cardholder being left with the contractual rights previously described. As EFT transaction cards become more prevalent this legal vacuum will likely impede their market acceptance. Uncertainty with respect to error resolution is likely to translate into unacceptability by consumers.

In an electronic environment errors will still continue to fall into the classification presently known in the chequing and credit card systems. The errors will continue to be caused by the parties; the financial institutions; unauthorized users or by the system of data processing not operating properly. The difference is that under EFT the balance of interests will change and therefore perhaps the rules should be different for transaction cards than for credit cards or cheques.

Once EFT transactions commence errors caused by the parties may not always be capable of direct settlement between the parties. The financial institution will have a role to play. For example, a POS terminal could be operated by the merchant's employee to effect the direct data entry of a transaction which was formerly done at the bank's data centre in the credit card or cheque systems. The first step for the cardholder would be to find out if the bank's records confirm that the amount transferred at the P.O.S. terminal was correctly entered on the descriptive statement. Once the bank has discharged this responsibility it should then be able to remain isolated from the dispute between the cardholder and merchant as it presently does with credit cards.

The absence of any standardized method of error correction for parties' errors in credit cards transactions makes it difficult to make recommendations concerning transaction cards. What is required is a statutory right of dispute resolution to deal with both credit cards and transaction cards. Such legislation should contain rights to receive copies of documents, defined time periods for investigations, a right to refund of credit charges and suspension of claims for payment while a matter is being investigated. The Fair Credit Billing Act [101] in the United States requires all of this and more.

The financial institution's responsibility with respect to these matters would be identical whether the error was caused by the parties or by the financial institution. The resolution of a financial institution's error will probably require additional statutory provisions beyond those described above. The major difference between credit cards and transaction cards in an EFT environment is that the latter will be the method of accessing an EFT account. All the supporting information concerning the transaction card will be within the financial institution's control. Therefore, certain minimum statutory standards of conduct in resolving financial institution

errors should be adopted.

Section 909 of Senator Riegle's bill provides for an error resolution mechanism. The scheme requires the customer to notify the financial institution within 60 days of receiving account documentation that there has been an error. The next stop is for the financial institution to conduct an investigation and report its findings to the account holder within 10 business days. If an error is discovered it must be corrected within one business day. If the financial institution cannot perform the investigation within the stipulated time periods then it must recredit the account until such time as an investigation can be carried out. A failure to follow the provisions can result in the cardholder having a statutory right to treble damages.

Similar error resolution methods are required in Canada. If the cardholder is required to notify the financial institution of an alleged error then this should become part of the obligatory disclosures at the time the EFT account is established. Once the cardholder has triggered the correction mechanism then the financial institution should be required to respond to the allegation of error within 10 business days. If this will prove impossible then the depositing institution should recredit the disputed item until it can investigate the matter and report to the account holder.

It is also recommended that if the financial institution reports that it has not made an error it should be required to turn over the documentation to the account holder. Such a requirement would enable the account holder to determine whether it should be pursuing a third party such as a retailer.

A transaction cardholder in an EFT environment will find himself in a different position with respect to errors caused by unauthorized use than under the present chequing and credit card systems. For certain types of transactions such as pre-authorized payments and payments through a POS terminal there

will be records from which the dispute may be capable of resolution. However, transaction cards will also activate ATMs and cash dispensers where the only record will be a receipt created by the machine and in the possession of the unauthorized user. The reason there will be no evidence of the unauthorized use is because the user will have both the transaction card and the PIN. The machine will, therefore, identify the user as apparently being authorized. In part this problem is caused by a lack of technology which can utilize unique identifiers of persons through such things as voice prints, machine readable signatures or fingerprints. Work is being carried on to develop such unique identifiers, however, for the present the system will utilize PIN numbers. There is no doubt that whereas unauthorized use in the cheque and credit card systems was primarily in the control of the financial institution it will be, in EFT, in the control of the cardholder. The loss of a transaction card with a PIN number attached will facilitate an unauthorized transaction. Whereas the loss of a credit card while of assistance to the unauthorized user still requires him to commit forgery and consequently gives the card acceptor a chance to identify the user as being unauthorized. In addition, the requirement of verification of a credit card with the data centre gives an additional opportunity to check on whether the user is authorized or not. This opportunity may not always be present with transaction cards in an EFT environment.

The problem of unauthorized use in EFT requires the balancing of the interests of the cardholders and the card issuers. Violent crime aside, careless conduct on the part of the cardholder is required before a person can become an authorized user. On the other hand if the EFT systems being utilized had unique identifiers such as voice prints unauthorized use would be impossible. The fact that card issuers are prepared to put EFT systems into the marketplace before the technology to solve the problem is available suggests that they should carry some of the risk of unauthorized use. The balancing of the interests appears to lie in the severity of the conduct of the cardholder.

The United States National Commission balanced the interests by stating that the EFT cardholder should have no liability for unauthorized use unless he kept the PIN number with the card or voluntarily permitted someone to have both the PIN and the card. The Commission also placed notification requirements upon the cardholder with the sanction that a failure to notify should result in the cardholder being responsible for the losses incurred.

The Commission rejected a general standard of negligence being placed upon the cardholder as being too vague and premature because of the lack of adequate technologically sound identification procedures. It did suggest that once the technology for infallible identification was present it might be appropriate to change to a negligence standard. The other consideration leading to their conclusion of no cardholder liability for unauthorized use except in defined circumstances was because of the possibility of total loss of money from the account. Unauthorized use in an EFT environment can have the appearance of being authorized and therefore has the potential to drain an account to zero.

The Commission's recommendation has been in large measure adopted in Senator Riegle's bill in section 910.

It is recommended that EFT transaction cardholders not be held liable for the unauthorized use of a transaction card except under defined circumstances. The only time when the cardholder should be liable for errors caused by unauthorized use should be when he has kept his card and PIN number together so that it can be stated that he substantially contributed to the loss caused by the unauthorized use. In all other circumstances the cardholder should not be liable for errors and resulting losses caused by unauthorized use. There should be a statutory duty on cardholders to recredit an EFT account when it receives notice of unauthorized use from the cardholder unless it can prove the cardholder has acted fraudulently in notifying the

financial institution.

EFT transactions in a real time mode may have errors created by systems malfunctions and therefore, it is necessary to have some type of statutory regime to take this into account. Systems malfunctions will not be the fault of either cardholders or acceptors. Nevertheless, one of them is likely to suffer from such errors and may not ultimately be able to recover any damages from the EFT provider. This issue is partially tied to the question of when a payment has been made in an EFT transaction[102] and must await the revelation of federal legislation defining the time of payment between debtors and creditors.

The financial institutions created the EFT systems as a more efficient method of doing business and maintaining their business records and they should carry the responsibility of their record keeping systems in all circumstances. However, all systems malfunctions will not be the fault of the financial institution. For example, they may be caused by communications or terminal problems. Nevertheless, the financial institution should be considered responsible for systems malfunctions. They are in the position to negotiate the division of liability with various third parties who create their record keeping system. If they are permitted to set up defences of third party carelessness or negligence in systems malfunctions, they may well be able to effectively avoid responsibility for matters for which (if other methods of record keeping were used) they would clearly be responsible.

The EFT user will only have to look to one party, the financial institution for satisfaction of his claims arising out of system malfunctions. This will make his action procedurally easier to maintain and so increase the likelihood that actions will be taken on his part, but he will still have to prove his losses in the event of a system malfunction. In this connection

penalties, interest and other charges should not be payable for transactions which are not completed because of a system malfunction. This is somewhat analogous to the financial institution's present responsibilities with respect to the wrongful dishonouring of cheques.

Finally, a customer who utilizes an EFT system which he knows to be malfunctioning should not be entitled to the protections described above and should do so at his own risk.

(iii) Stop Payment/Chargebacks

The issue of whether to have stop payments and chargebacks in an EFT environment arises because of their existence in the present chequing and credit card systems. A stop payment in the chequing system[103] can be initiated by the payor, who is also the drawer, up until final payment is made by deducting money from his account. The counterpart of the drawer's stop payment power is the financial institution's (drawee) power of charging back a cheque. A chargeback can be made until final payment terminates the right to make any claims.[104] Neither the drawer nor drawee require any recourse to the courts to exercise their rights.

The drawer always has the legal right to countermand (stop payment) as against the bank until final payment. This right when exercised has the effect of stopping payment as against the payee because the cheque, given in payment, will no longer be borrowed by the drawee's financial institution. This effect on the transaction for which the cheque was given in payment may or may not be considered a legitimate exercise of a legal right. That issue is resolved by examining the transaction to ascertain whether or not the payor had the legal right to repudiate the transaction because of some breach caused by the payee. For example, defective goods might have been sold. If the defects amounted to a breach

of the implied obligations of the Sale of Goods Act then the payor might have a legal right to repudiate the contract. Similarly a financial institution who is a drawee can only make a claim for recredit in limited situations such as in the case of the forgery of the drawer's signature. A chargeback which has been triggered without the concomitant legal right is one which would not be sanctioned upon judicial review of the matter.

In contract, in the present credit card systems there is no right for the cardholder to stop credit (payment) as there is with cheques. However, the card issuers have preserved their chargeback rights and increased their scope. For example, in the merchant agreements the card issuer's right to chargeback for forgery is not restricted to unpaid items as it is in the chequing system. Furthermore, the chargeback can be made on a number of other grounds[105] such as if the cardholder refuses to pay the issuer.

The financial institution has a right to chargeback in both the chequing and credit card systems. The introduction of credit cards was seized upon, by the financial institutions, to broaden their right to chargeback in credit card transactions. It is likely that the introduction of EFT transaction cards is likely to be used as an opportunity to broaden the financial institution's chargeback right while further restricting any consumer right to stop payment or reverse a transaction. This concomitant right of stop payment has been restricted in the chequing system by the shortening of the time period it takes for clearing cheques and, therefore, the time period in which a countermand can be effected. Even this limited stop payment right is not present in the credit card system. It is not likely to be present in an EFT environment unless it is made obligatory by statute.

Transaction cards in an EFT environment could have either a debit or credit function or a combination of both. As was mentioned above, the cardholder's right to a stop credit or chargeback is based upon agreements centering on the present stop payment right associated with cheques. If the transaction card is utilizing electronic equipment in a real time mode then the equivalent EFT concept to the stop payment is a reversal of the transaction. There would be no time in which a stop credit order could be made because the transaction would be instantaneous. This reversibility right has also become known as a chargeback right because that is what is done in reversing a transaction. It is charged back against the person who received payment.

The Law Reform Commission of Canada has recommended that a chargeback right be established for transaction cards.[106] Their reasoning is that a power to withhold payment or a right to reclaim it without legal process shifts the burden of suit away from consumers using a transaction card. It is argued that many merchants already have marketing policies such as "satisfaction or money back" and that such policies are effectively allowing consumers to chargeback against the merchant. The effect of such a chargeback right when the transaction is effected in an EFT mode would be indistinguishable from a consumer oriented policy for adjustments and returns. This position leads the Commission to conclude that the incidents of complaint are predictable and the merchant can create a pool of working capital from which to pay for chargebacks.

The National Commission in the United States dealt with chargebacks on the basis of a universal right to reverse a transaction for a limited number of days. It noted that the stop payment right involving cheques was a limited protection in the chequing system in that it only lasted until final

payment had been made. It also noted that its use in the cheque system has been infrequent. It argued that EFT chargebacks may be no more frequently used than the stop payments for cheques. There was also a definite split of opinion between people who testified before the Commission as to the necessity of chargebacks in EFT. It, therefore, recommended that there be no legislation dealing with the matter. It was felt that conflicting market interests and differing operational characteristics of EFT system are likely to allow for chargebacks in some cases and not in others.[107]

Senator Riegle's Bill[108] which was introduced in the senate to take account of many of the recommendations of the National Commmission initially provided for the reversibility or chargeback of "... an electronic fund transfer initiated by a consumer to a third person in the amount of $50.00 or more." This was very similar to the proposals of the National Consumer Centre in its proposed National Consumer Act.[109] This provision in Senator Riegle's Bill was deleted by the Senate Banking, Housing and Urban Affairs Committee.[110] However, a similar provision has remained in Representative Annunzio's EFT Bill.[111]

In Canada neither the legislatures nor the courts have dealt with the issue of chargebacks. The present card issuer merchant agreements preserve unto the card issuer the chargeback right in a number of circumstances. One such occasion is defined as follows:

> "... the merchandise referred to in the sales draft has been returned to the merchant or the services referred to in the sales draft are claimed by the cardholder to have been unsatisfactory..."

A further provision for a chargeback right which has relevance to this paper reads as follows:

> "... the transaction evidenced by the sales draft or any credit extended in respect thereof is, for any reason, illegal, null or void..." [112]

The above provisions expand the right of the card issuer to chargeback against the merchant. The cardholder agreement requires the cardholder to settle disputes directly with the merchant. Presumably, if the cardholder complained long and bitterly the card issuer would utilize his chargeback right. Therefore, the marketplace has tacitly recognized a chargeback right which could be triggered by consumer complaint. The issue is whether this practice should be converted into a legal right of the cardholder to chargeback rather than a discretionary right under the card issuer's control.

A consumer cardholder right to chargeback, when exercised would have the effect of shifting the burden of suit to the merchant. As was argued by the Law Reform Commission of Canada many merchants already have a sales return and adjustment policy as a marketing strategy which is similar to a chargeback right. A consumer chargeback right is, therefore, not a new right. What is really involved is a question of whether it should be extended to be a legal right and be operative against all merchants, not just those who have it as a marketing strategy. It is argued that one of the advantages of giving a chargeback right is that it will have the effect of inducing cardholders to police merchants' activities. [113] This point of view is based on the characterization of transaction cards as being no different than a direct extension of credit by a merchant who then assigns his account receivable. The card issuers respond by noting that such a characterization does not take account of the multipartite nature of transaction card relationships. The card issuer would characterize the transaction not within an assignment or factoring notion but a direct obligation theory. The cardholder's obligation as to credit, payment and interest charges are all directly with the

bank, there is nothing for the merchant to assign. The differences between the cardholder's position and that of the card issuer are not reconcilable. The proof of the fact can be seen from the history of the issue in the United States. The cardholder's argument is designed to improve the lot of the individual consumer.

The card issuer's argument is technically difficult to rebut but takes no account of new perceptions concerning the relationship of consumers to those who provide them with goods and services. If this debate is not reconcilable then it only remains to be seen how disruptive a right of chargeback would be.

If chargebacks were granted, many merchants with sales return and adjustment policies would need to make very few changes in their operating procedures to take account of chargebacks. Furthermore, all merchants presently accepting credit cards must have such procedures because of the card issuers' contractual rights of chargebacks against them. Therefore, arguments concerning administrative impossibility or a flooding of reversed transactions do not seem to be justified.

The resolution of the chargeback issue for any particular proponent is a function of the characterization that proponent selects as the proper one for transaction cards. However, there do appear to be some facts which suggest that chargebacks may be appropriate regardless of this philosophical debate.

The chargeback currently exists as a right in the marketplace but it is only exercisable with the card issuer's consent. The present card issuer merchant agreements for credit cards all preserve this chargeback right for consumer transactions where they deem it proper to chargeback. This suggests it is not a big

step to convert chargebacks into a legal right for cardholders. In any event in an EFT environment transaction cards will have some chargeback, or perhaps a better term is reversibility rights with respect to billing errors and unauthorized use as was described above under these headings. This will require that all the mechanisms to handle chargebacks be present both for merchants and card issuers. Furthermore, many merchants recognize an ad hoc right of chargeback in their satisfaction or return policies. It is, therefore, recommended that a chargeback right be attached to transaction cards in Canada.

It is recommended that a chargeback right should be available only after discussions with the merchant as to settlement of the differences. An arbitrary dollar limit should exist below which there would be no chargeback right. However, it is not necessary to attach geographic limits to the right because of the different composition of the Canadian financial industry.

The granting of a chargeback right has some further implications. Should the right apply to transactions for services? There is no difference between service transactions and sales transactions from the point of view of the proponents and detractors arguments concerning chargebacks. The factual difference is that a service has generally been consumed, i.e. a meal eaten, night spent in a hotel room etc. On the other hand the transaction card will also make available other services, such as cash withdrawals. If the machine fails to dispense cash a chargeback right should exist. Therefore, rather than try to legislatively differentiate between sales and service transactions a uniform right of chargeback should be given. Then in cases where the services have been consumed the burden will be shifted to the merchant to bring legal action for recovery on the basis of the law of restitution. If

discussions with the card acceptors are a condition precedent this should not be a major problem.

Embodied in the above recommendation is the notion that the chargeback right cannot be allowed to be a right to reverse a transaction capriciously. It should be based on the legal right to do so, not just the power to do so. This brings into play the effect of the idea that chargebacks merely shift the burden of suit from the cardholder to the merchant or card issuer. Therefore, the statutory right of chargeback will be subject to judicial review.

It is recommended that the statutory right of chargeback not include the universal right to reverse a transaction for a specified time period in order to replicate the stop payment power of cheques.

The acceptance of the recommendation of a chargeback right will affect existing rights with respect to mechanics liens[114] and the Sale of Goods Act.[115]

The repairman's lien under the Mechanics Lien Act is a wholly possessory one.[116] Chargebacks could have the effect of totally circumventing the lien right. The only way of preventing this would be to provide for registering of the lien. The Ontario Law Reform Commission's Report on the Non-Possessory Repairman's Lien[117] recommended legislation to permit registration of a non-possessory lien. If such legislation were enacted the problem arising from the granting of chargebacks would be solved.

Under the present law of sales, a repudiation of the contract must occur together with a return of the goods before a claim for the return of the purchase price can be made. The granting of a chargeback right is to be conditional upon discussion with the merchant. If the transaction is to be chargebacked then a

statutory requirement to return the goods sold should be enacted. Such an obligation should be embodied in any legislation which comes forth from the Ontario Law Reform Commission project concerning sales law.[118]

(iv) Preservation of Consumer Defences:

Many commentators have not drawn a distinction between the preservation of consumer defences against the card issuer and the question of chargebacks. A chargeback which is merely a reversal right designed to duplicate the stop payment right of the chequing system does not have to be attached to any legal right to reverse the transaction. Therefore, in this respect chargebacks are distinct from consumer defences. Chargebacks which involve more than the reversal right similar to cheque stop payments are also distinct from the consumer defences question. The preservation of consumer claims and defences against the card issuer can be viewed as merely giving a statutory right of protection when suits are launched against cardholders by financial intermediaries. Whereas the chargeback right of a cardholder enables the consumer to shift the burden of suit to the merchant because the transaction has been reserved. It enables him to convert what would otherwise be defences or claims to a suit for payment into a cause of action. Therefore, they are separate issues although the granting of a chargeback right in some respects assumes the right to assert defences and claims against the card issuer.

The term "consumer defence" refers to a right to raise some complaint when an action for payment is brought. However, if the price has already been paid the defence can no longer shield the consumer and he must launch an action. It is in this respect that the chargeback becomes a convenient self help remedy for the cardholder.

The chargeback and the consumer defence do not have identical applicability in two party transactions (e.g. between merchant and consumer) and tripartite transactions (e.g. between a merchant,

card issuer and cardholder/consumer). In a two party transaction there is no necessity to preserve defences as both parties have all the causes of action and defences arising from the contract to which they are both parties. The chargeback would reverse the transaction having the effect of always causing the merchant to bring a suit for payment. Without the chargeback the merchant's suit would be the same but the cardholder would have to maintain a separate action for complaints regarding defective goods or some other matter involving loss of bargain.

In a tripartite transaction the merchant receives his payment for the merchant/cardholder transaction long in advance of the card issuer collecting payment from the cardholder/consumer. It is this fact that raises the issue of whether the cardholder should be entitled to raise defences to the issuer's claim for payment which he might have raised in a direct suit by the merchant for payment. The necessity to preserve the cardholder's defences arises from the fact that the collectors of the debt, the card issuer, was not in privity of contract with the merchant and cardholder. The chargeback right has the same effect as it does with the two party transaction in that it places the burden of suit upon the merchant. The chargeback then has the effect of permitting the card issuer to drop out of the transaction and again places the cardholder and merchant in the position of a two party transaction. Therefore, if there is a preservation of defences right the cardholder will defend against the card issuer, if there is a chargeback right, the consumer will defend against the merchant.

The preservation of consumer defences against third parties has been recognized in Canadian law in transactions involving the assignment of the consumer's obligation to a merchant to a third party and the registration to a third party of a negotiable instrument executed by the consumer. Unscrupulous merchants and financial intermediaries have in the past used these techniques

to isolate the consumer from his remedies when secured financing of the sales transaction has been present. An example would be the purchase of a car, the giving of a purchase money security interest in it to the merchant who then assigns the contract to a financier. The common law would have freed the holder of the consumer's obligations from his defences either because the holder was an assignee for value [119] or because he was a holder in due course of a negotiable instrument.[120] In 1971 the federal and provincial legislators put a stop to these practices by enacting amendments to the Bills of Exchange Act [121] and the Consumer Protection Act. [122] The effect of this legislation is to reverse the common law position and enable the consumer to assert his defences against a holder of an obligation who is either an assignee for value or a holder in due course. [123] However, this right to assert consumer defences or claims has to date been limited to situations where the third party has become involved because the transaction is being financed with a security interest being taken in collateral to secure the loan.

While in the past financiers have attempted to isolate themselves from consumer defences with their finance contracts, the card issuers are now attempting to isolate themselves from the consumer defences with their credit card contracts. The clause which accomplishes the isolation is the one requiring merchants and cardholders to settle disputes directly.[124] On the merchant side of the tripartite relationship it is augmented by the chargeback right of the card issuer. The direct settlement clause could be considered as a cut-off clause if the card issuer refused to effect a chargeback and sued the cardholder for payment under the terms of the contract. [125] It is more likely to be so considered if the proper characterization of the credit card is an assignment or factoring by the merchant. It is debatable whether S 42 (a) of the Consumer Protection Act applies to a cut-off clause in a cardholder agreement.[126]

In the United States the preservation of consumer defences

against the cardholder were extended to apply to credit cards by the Fair Credit Billing Act. No equivalent legislation has been enacted in Canada.

In the United States the Fair Credit Billing Act[127] has provided for the assertion of consumer defences in connection with the use of credit cards.[128] Section 170 of the legislation provides for an assertion of defence against the merchant if:

. . .

(1) "the cardholder has made a good faith attempt to obtain a satisfactory resolution of a disagreement or problem relative to the transaction from the person honouring the credit and;

(2) the amount of the initial transaction exceeds $50.00; and

(3) the place where the initial transaction occurred was in the same state as the mailing address previously provided by the cardholder or was within 100 miles from such address. The other major limitation or the right is that the claim or defence asserted by the cardholder may not exceed the amount of credit outstanding with respect to such transaction at the time the cardholder first notifies the card issuer or the person honouring the credit of such claim or defence."

. . .

The arbitrary dollar figure was established to ensure that chargebacks did not become a burden on the system.[129] Transactions involving low dollar amounts incur the same processing costs as large dollar amounts. Therefore, the percentage processing cost obviously is greater for low-dollar-value transactions. The right to chargeback would further increase that cost figure to the point where the processing costs exceed the value of the transaction. This is one argument for the establishment of an arbitrary dollar amount which must

be exceeded before there is a right to chargeback. The other justification is that for low dollar transactions the credit card is frequently used as a substitute for cash and not because of any desire to use the credit features of the card. Again because of the American philosophy of replicating the existing payment schemes at the time of forming legislation involving a new scheme it was accepted that because there has never been a chargeback right for cash transactions there should not be one for credit card transactions where the card is being substituted for cash. The arguments of the Canadian Law Reform Commission demonstrate that it follows this proposition. Furthermore, the slavish devotion to emulating rights already in existence in a particular payments mechanism is likely to retard the full development of such new mechanisms potential to assist consumers. Truly, the fact that the processing cost for a chargeback would for small transactions exceed the value of the transaction is sufficient justification for the imposition of an arbitrary threshold limit for the availability of a chargeback.

The geographic limit in the American legislation was introduced to take account of functional dispersion of the bank credit card system in the United States.[130] The bank system of the United States contains thousands of financial institutions with both federal and state regulations on the function and services they can provide. American Bank issue charge cards to the public and establish an account on behalf of the persons to whom the card is issued. Merchants enter into agreements with any bank (the depositing bank) wherever it is located provided the bank is a member of the interchange system. Therefore, the depositing bank and the issuer may be separated by thousands of miles and the interchange clearing process may involve two or more registered clearing associates and several banks. This is what is known as functional dispersion and is the primary reason lying behind the geographic limit in the <u>Fair Credit Billing Act</u>. The necessity for such a limit in Canada is less

compelling because with only 12 chartered banks, most of which are national in operating scope, and only 7 of whom issue credit cards, there is not the same degree of functional dispersion.

The National Commission on EFT in the United States dealt with the question of consumer defences in connection with its discussion on reversibility.[131] It was their view that the marketplace was the proper arena for resolution of the issue. Such a view is not applicable to Canada because of the absence of equivalent legislation to the Fair Credit Billing Act.

As the use of transaction cards increases the importance of the consumer defences issue will grow. There is a need for clarification of the situation for both credit cards and transaction cards. It is apparent that without legislation to alter the situation the principle of freedom of contract will ensure that the cardholder will not be able to assert defences against the card issuer. The credit card arrangements is proof of this point. As long as the marketplace is dominated by oligopolistic suppliers of transaction cards it is certain to leave the cardholder without defences against the card issuer. If the card issuers wish to expand their business by issuing cards they should no longer be able to assume only the credit risk. The banks maintain that in any lending system the only risk they assume is the credit one. However, that ignores the fact that transaction cards are not just loan transactions but an alternate mode of payment. If looked at in this fashion there is no reason why they should not assume some of the marketplace risk. The proposition has already been accepted with respect to secured financing.

It is recommended that legislation similar to the provisions concerning assignments in section 42a of the Consumer Protection Act be enacted to prevent isolation of card issuers from the defences of cardholders. Such legislation should be complimentary to the chargeback provisions and contain the same types of

restrictions as recommended with respect to chargebacks.

D. SHARING:

A major issue has emerged in the United States over the extent to which institutions may co-operate in order to develop, establish and operate EFT systems. The interviews carried out with deposit taking institutions in this province indicate that very little thinking on the sharing issue is being done by that sector of the financial industry. The brief of The Association of Canadian Financial Corporations (ACFC)[132] to the Justice Group on EFTS indicates however that the non-deposit taking financial institutions are concerned with the sharing issue. The Economic Council of Canada has indicated it is aware of the issue and it appears to be the only public body to have made reference to the issue in a Canadian context.[133]

It is generally accepted that an EFT capacity would give a financial institution a competitive advantage in the marketplace. The Economic Council of Canada has expressed concern about the inability of the non-bank depositing institutions to participate in the credit card system.[134] This concern was expressed in the form of a recommendation that all deposit institutions be assured access to existing bank card systems. The brief of the ACFC suggests that they also are concerned that the non-deposit taking institutions' function in relation to credit will be eliminated by EFT developments unless there is a right of access to the system and a universal card to activate the system.

On the latter question of a universal card the federal government stated in "Towards an Electronic Payments System":

> "The generally acceptable credit card or some similar card will probably evolve into a machine-readable credit payment card which will provide public access to the electronic payments system..."[135]

The Economic Council of Canada subsequently picked up on this point in recommending that "...the specifications for a national cash card in Canada be promulgated in such a way as to allow for its simultaneous introduction by all deposit-taking institutions."[136] In another publication the Council recommended that all deposit institutions be assured access to the present bank card systems through compulsory licensing.[137] All of these statements suggest that sharing of the system should occur and that it will require a single universal card for access. But two statements ignore the interests of non-deposit taking institutions and their possible participation in any EFT system.

In the United States the sharing issue is centred more upon the concern that sharing EFT will reduce competition between institutions.[138] The Canadian focus in this issue may be, the converse, centering upon the possibility that sharing may enhance the ability of small deposit taking institutions (such as consumer loan companies) to compete against the dominant big five, Canadian chartered banks. This concern is also recognized in the United States in that institutions unable to develop their own EFT system may suffer substantial competitive disadvantage if not allowed access to a system operating within its market. The United States National Commission balanced the concern for competition against that of squeezing out small institutions by developing a notion of "pro-competitive sharing." This notion permits sharing, but the sharing arrangement can be challenged and reviewed by a regulatory board and would be subject to federal anti-trust law. The adoption of such a recommendation would require the nullification of the legislation of 14 states which make sharing mandatory in one form or another.

The arguments in favour of mandatory sharing in the United States marketplace centre on the following points:

(i) The cost of the hardware is high. Sharing would

allow pooling of capital and would minimize one risk of EFT development.

(ii) All financial institutions would have access to a shared system. Consumer convenience would thereby be increased and small banks would not be frozen out.[139]

(iii) Mandatory universal sharing would eliminate the problem of unlawful combines which would restrict competition and monopolize the EFT market.[140]

(iv) Mandatory sharing may hasten the acceptance of EFT.[141]

(v) Sharing of any system(s) would reduce costs by eliminating duplicated effort.

(vi) A bank clearing house may be an essential facility. By the same reasoning elements of an EFT switch could be too.[142]

These arguments have been persuasive in encouraging 14 states to enact mandatory sharing legislation. Although this might change as a result of the National Commission on EFTs limited acceptance of the concept[143] and the possible passage of a Bill proposed by Senator McIntyre[144] which adopts many of the Commission's recommendations in this regard.

The arguments against sharing which to this point have been less persuasive with state legislators are;

(i) The market response of EFT suppliers would be diminished if competitive advantage were limited by mandatory access.

(ii) Innovation would be limited with the restriction of competition for access.

(iii) A system with unlimited access might be prone to fraud, and overload.[145]

Senator McIntyre's bill in S.5[146] adopts some of the National Commission's recommendations in its proposed legislation. The bill purports to establish federal jurisdiction over EFT by pre-empting state legislation which mandates access to an EFT system by persons not so entitled by agreement with the proprietor. Subsections (b), (c) and (d) then go on to establish a statutory mechanism to assist financial institutions in gaining fair access to an EFT system.

Many of the pro and con arguments on the sharing issue in the United States do not have much relevance to Canada, although certainly the consumer convenience argument does. The argument concerning cost reduction because of sharing is double edged in this country. In the first place the primary actors in the EFT environment are the chartered banks. Their need to pool capital in order to invest in hardware or software is virtually non-existent. That same fact operates as a barrier to other financial institutions, who are a great deal smaller, entering the EFT marketplace. If they do not pool capital the financial investment will keep them from participating.

The arguments against sharing in the United States all focus on the fact that sharing is likely to produce an oligopolistic marketplace for EFT suppliers and users. In Canada we already have such a marketplace for EFT systems. Therefore, the arguments appear to have little relevance for Canadians. This appears to be why the Economic Council has made recommendations concerning sharing without extensive economic analysis of the issues involved.[147]

The sharing issue is certain to emerge in Canada despite the attitude of the dominant banks that there is no need for it. Ultimately the point-of-sale systems are going to require shared facilities if the public is to be best served. Transaction cards will, therefore, have to be universally acceptable and operate shared terminals. Most retailers would not tolerate proprietory terminals as it would automatically exclude certain customers from utilizing the system. Several of the large supermarket chains in Canada have formulated EFT policies which require that POS terminals be shared before installation in the supermarket can occur. This practice is little different than these stores present one of accepting all cheques regardless of which institution they may have been drawn upon. It therefore, appears that the convenience and needs of consumers, as well as the retailer's interest in economy of operation, are likely to cause the issue of sharing to arise in Canada.

There has been virtually no public debate of the sharing issue in Canada. The primary participants appear to have done very little thinking about the matter and public bodies have paid only nodding attention to it. It is premature and foolhardy to make policy recommendations concerning this issue in Canada. The issue is a broad one requiring public debate and careful quantitive economic analysis. It is recommended that action be taken to develop the information necessary to identify the issues and policy considerations in order to be able to make a decision about sharing in the EFT environment. In undertaking such a study the following matters need to be examined:

(1) Should the sharing regime be permissive or mandatory?
(2) Should only the terminals be shared or also the switches and communications systems?
(3) Who must share with whom?
(4) What would be the basis of such sharing in terms of operations and costs?

(5) Should there be a universal card to access the system?

SUMMARY OF TRANSACTION CARD RECOMMENDATIONS

1. The relationship between the consumer, card issuer and merchant involved in a credit card transaction is created in part by contract. The result is a hybrid commercial device that has some characteristics of many of its better understood predecessors. This state of affairs, means that while many statutes and common law rules may apply to credit card transactions, it is totally unclear which rules do in fact apply. It is largely a question of characterization, an observation which helps very little. The need for certainty in this area stems from the need to balance the interests of all participants. The urgency of this need will not abate with the spread of electronic payments, but will increase. Therefore it is urged that the province consider legislation which would provide legal certainty by defining the rights and obligations of all parties to credit card transactions with respect to, inter alia; the distribution of unsolicited cards, the apportionment of loss resulting from unauthorized use, the disclosure of terms, the availability of consumer defences vis a vis the banks and the right to chargeback.

2. In particular, consideration should be given to the following:

(a) Modification of S.36 and 41 of The Consumer Protection Act (CPA) so that it requires, at reasonable times and in advertising, the disclosure of the cost of borrowing associated with credit and transaction cards.

(b) Amendment of S.37 of the CPA so as to include all card issuers within the definition of "lender" and thereby

require rate disclosures at the time of establishing a credit card or transaction card account.

(c) Amendment of S.42 of the CPA so that cardholder defences arising from the transaction with the merchant may be asserted against the card issuer.

(d) The statutory enactment of limited liability for unauthorized use.

(e) The prohibition of unsolicited transaction cards.

(f) The requirement of general disclosure of all terms and conditions applicable to the relationship, including costs, loss shifting clauses, error correction procedures, customer rights and the debit credit switchover.

(g) The prohibition of liability until notice clauses in credit and transaction card contracts.

3. At the present time consumers enjoy a choice when it comes to the mode of payment of a debt. Cash, cheques and credit cards are the main alternatives. For reasons of economy of scale, among others, some creditors prefer one mode of payment over others. Large creditors like chartered banks have the power to coerce consumers into using one mode or another. The means may be direct, as in a contract of adhesion, or indirect as in the case of discounts either to consumers or merchants. Universality of use is a key to making EFT systems cost-effective and therefore the temptation to use economic coercion on the consuming public will be great. Such a possibility must be prohibited to insure the continuity of consumer choice in the field of the delivery of financial services.

4. A corollary of the principle that consumers' choice must be preserved is the principle that low income consumers must not be denied access to EFT systems which could provide financial services at rates lower than this segment of the population now pays. As servicing this group is a high risk venture, it is not anticipated that the desired result would be achieved without government intervention. It is recommended therefore that the government co-operate with card issuers in providing financial inducements to insure low income access to EFTS.

5. When a consumer has effected a non-cash transaction, he depends in part on others to complete the transaction for him. For example when writing a cheque or signing a sales draft the consumer relies on the bank to debit the correct amount from his account and pay it to the proper payee. Since these functions are beyond the immediate control of the consumer he must, to avoid error, verify transactions after the fact by reviewing cancelled cheques and credit card billing statements. Cancelled cheques serve not only to satisfy debtors that the proper payments have been made but as well to prove payment to a doubting creditor. The value of a descriptive billing statement as proof of payment remains unclear at present, but they at least allow debtors to monitor their credit card accounts. These two facets of cheques and credit cards must be preserved in an EFT environment if it is to be acceptable to consumers and workable from a dispute settlement point of view. To ensure this objective it is recommended that consideration be given to statutorily requiring documentation of every EFT transaction, stipulating the contents of such documentation and providing for the evidentiary efficacy of such records. Likewise, consideration should be given to mandating the contents of descriptive billing statements to insure their utility.

6. Recommendation number 5 recognizes that errors are an inevitable part of transactions involving payment and suggests measures which would assist in their detection. There must also be a method of error correction. Current payments errors are resolved by reference to a body of law which has an undetermined relevance to credit card transactions. Thus error resolution in that scheme and in future EFT systems is largely an unknown quantity. It seems likely however that as the number of EFT participants increases, the number of errors will also increase, and that a new species of error, the systems manfunction error, will evolve. An allied problem is the question of where the burden of error induced losses must fall. An observable tendency in response to these uncertainties has been that of card issuers shifting responsibility away from themselves, at the expense of the cardholders. Not all systems errors will be the fault of the financial institution. Some will undoubtedly be traceable to communications suppliers. Even so it is recommended that the financial institution bear this responsibility because they can divide liability with their suppliers. Otherwise another business risk will be shifted to the consumer. To prevent further erosion of the cardholder's position and to insure an adequate method for error resolution and loss placement, it is recommended that minimum standards of conduct in that regard be enacted. For this purpose Senator Riegle's EFT bill is a model worthy of examination.

7. The problem of the unauthorized use of credit cards takes on an added dimension in an EFT environment. In the present cheque and credit card systems the user is identified, in theory at least, by his signature, and in fact, some transactions in each system are aborted on the basis of an irregular signature. In an EFT system it is likely that identification will be based on a personal identification number known as a PIN number. As a result anyone with a

transaction card and the PIN number will have the appearance of authenticity. This fact changes the locus of responsibility for preventing unauthorized use from the card issuer and merchants who must verify signatures, to the cardholder, who must keep the PIN number secure. The unauthorized use issue reduces to whether the cardholder should be responsible for some or all of the loss resulting from his careless handling of a PIN number or whether the financial institution which established the system should be. Placing too much of the risk on the cardholder may adversely affect acceptance of EFT systems while the converse may result in cardholder carelessness and large losses. It is recommended that statutory measures be taken to exempt cardholders from liability for unauthorized use except when he substantially contributes to the loss by keeping his card and PIN number together. To make this exemption meaningful, the statute must also provide for the re-credit of unauthorized transactions on notice from the cardholder except in cases of fraud.

8. When a consumer pays for merchandise with a cheque he can countermand the cheque before it is paid by his bank. This right exists only between the bank and its customer and does not affect the relationship between the merchant (payee) and the customer (payor) in any way. The customer still owes the merchant the price of the goods and if the customer in fact had no legal right to refuse payment, then by stopping the cheque the customer breaches the sales contract and will be liable for the price of the goods and possibly even damages. The stop payment merely shifts the burden of suit to the merchant in situations where the customer seeks to avoid a sales contract because of defects in the goods sold. In a credit card system governed by the cardholder/card issuer contract there is no such stop payment right because none is granted. In a real time EFT system stop payments are impossible because the transaction is completed instantaneously, the parallel right would be to reverse the payment transaction. Again neither of these

exercises affect the obligations under the sale contract. With the disappearance of the cheque, the stop payment right now enjoyed by consumers will also vanish unless a similar right of chargeback is statutorily created. It is recommended that this be done, but it is to be emphasized that a mere replication of the stop payment rights associated with the cheque system is not advocated. The new right should apply to sales of goods and services, the value of which is above a fixed dollar amount to prevent unnecessary expense and should only be available where the consumer has a legal right to resist payment of the contract price. The right to effect chargebacks must also carry the obligation to return the goods over which the payment dispute arose. A final condition precedent to the availability of the chargeback right should be the requirement of bona fide attempts to resolve the dispute between the merchant and the consumer.

9. The concept of a consumer defence refers to those defences which are asserted against financial intermediaries associated with consumer transactions. In the past unscrupulous merchants effectively isolated themselves from consumer complaints regarding defective goods by assigning conditional sales contracts to third party financiers who would give the merchant the value of the goods but who were not subject to the equities between the customer and merchant. The consumer always had a right of action for damages against the merchant, but the burden of suit to recover the damages was sufficient to inhibit most such actions. S.42(a) of the Consumer Protection Act (CPA) now protects consumers from these practices by preserving their right to assert defences flowing from defective merchandise against the financiers. When card issuers extend credit to cardholders, they act as financiers but may be immune to consumer defences. This is so because S.42(a) of the CPA may not apply to the card issuers because of the definitions contained in that act. As the volume of credit card transactions increase and card issuers abandon their market strategy of not enforcing their strict legal rights against

cardholders, the importance of whether S.42(a) is applicable to card transactions will escalate. It is recommended therefore that legislation similar to S.42(a) of the CPA but with applicability to transaction cards be enacted to prevent the isolation of card issuers from the defences of the cardholders. Such a statute should be complimentary to the chargeback enactments recommended above, and should provide for similar limits on the availability of the consumer defences. That is to say, the existence of the defences should be dependent on prior negotiations and be limited to transactions above a fixed dollar limit.

10. The development, establishment and marketing of EFT services is an expensive enterprise. In the United States, where financial institution's resources are less concentrated than they are in Canada, this fact has resulted in co-operation between financial institutions as a means of reducing the investment risk associated with this innovation. The term sharing refers generally to the co-operative establishment and use of EFT hardware and software. An EFT capacity represents a competitive advantage for a financial institution and this fact, coupled with the aforementioned co-operation, raises the spectre of unfair competition by illegal combination and monopoly in all its varied forms. In the U.S. finance industry, the major implication of unfair competition would be the elimination of smaller institutions which could neither join in the system nor compete with it. In Canada on the other hand co-operative EFT ventures may be the only way that the near banks can continue to compete with the chartered banks. The consumer also has an interest in sharing as it represents a factor in the ultimate cost and convenience of financial services. The ultimate impetus toward sharing will likely come from retailers who will wish to have one EFT facility to attract business, but not a multitude of expensive terminals and systems. The economics of scale also militate toward having the largest number of participants and this of itself implies

sharing of a system, which if it is not universal, should at least be standardized.

The sharing issue is complex and far reaching, it has implications which go to the very heart of the Canadian economic structure. Yet, there has been little debate on the subject and as a result an information base from which to develop policy is lacking. It is recommended therefore that developments in the sharing field be monitored so that interest groups and issues can be identified and defined with a view to the ultimate development of criteria for policy determination. In compiling such data consideration should be given to the primary questions of whether sharing should be mandatory or permissive, who should share, what should be shared and at what cost.

FOOTNOTES

1. There are two marketing strategies. In the United States Interbank Card Association, licensor of Master Charge, plans to introduce SIGNET nationally as a paper-based debit card during the fall of 1978. Visa, on the other hand, is introducing its debit function as an additional function of its present card. "Payments Systems Newsletters" PSI Vol. 10, #3, March 1978.

2. Binhammer, Deposit-Taking Institutions; Innovation and the Process of Change, Economic Council of Canada, 1976, p. 106.

3. Ibid., p. 106.

4. "Credit Cards" The Financial Post, April 8, 1978, p. 35.

5. "Implications of issuing credit cards being studied" Globe & Mail Report on Business, May 4, 1978, B.3.

6. Efficiency and Regulation, Economic Council of Canada, 1976, p.108.

7. Branching Out, Dept. of Communications, May, 1972, Vol. 2, p.71.

8. "Payments Systems Newsletters" PSI Vol. 10, #3, March, 1978.

9. "Implications of issuing credit cards being studied" Globe & Mail, Report on Business, May 4, 1978, B.3.

10. Ziegel, "Canada Regulates Consumer Notes" 26 Business Lawyer, (1971), p. 1455.

11. A copy of a contract is in Appendix A.

12. A copy of a contract is in Appendix B.

13. Gropper, The Credit Card in Canada, p.7.

14. Ibid., note 27.

15. Falconbridge, Banking and Bills of Exchange, 7th ed. page 410.

16. Ibid., p. 464.

17. Ibid., p. 468.

18. See the Chargex sales draft (customer copy above).

19. Falconbridge, Banking, p. 463.

20. See note 3, supra.

21. Falconbridge, Banking, p. 468.

22. Ibid.,p. 468.

23. Ibid.,p. 469.

24. Section 23 of The Bills of Exchange Act, provides a bill that is payable on demand if no time for payment is expressed thereon.

25. As to the consequences of computerized and descriptive billings and other innovations replacing paper documents now in use, see Working Paper #7 on the subject of Evidence. As to the consequences of non-presentment, see Falconbridge, Banking, p.691.

26. Brandel & Leonard "Bank Charge Cards: New Cash or New Credit" 69 Michigan L.R. 1033, (1970-71).

27. It is submitted that there can be little complaint that this is not the name of a bank as the "cheque" always finds its way to the proper bank, addressee, and account, as a result of this number.

28. Rogers, Falconbridge Banking and Bills of Exchange (7th ed) Canadian Law Book, Toronto (1969) p. 857-860.

29. Falconbridge, Banking, p. 896.

30. Messrs. Maffly and McDonald observed that the merchant-bank agreements in the United States required merchants to "assign" or "endorse" to the bank all the "sales drafts," "charge slips" or accounts representing sales made to cardholders. Endorsement of the draft is consistent with the promissory note analogy, but the visa merchant-bank agreement merely requires the merchant to "deposit" the draft. It is submitted that "deposit" is consistent with the promissory note analogy also.

31. Falconbridge, Banking, p. 883..

32. Ibid., p. 6.

33. (1846), 12 C.O. & F. 787 at 805.

34. David King, The Legal Nature of Travellers Cheques in Canada, Legal Research Institute of the University of Manitoba, p.16.

35. (1758), 1 BURR. 452 at 457.

36. King, Travellers Cheques in Canada.

37. Ibid., p. 18.

38. Ibid., p. 19.

39. Ibid., p. 18.

40. Ibid., p. 20.

41. L.H. Thompson Jr., "The Applicability of the Law of Letters of Credit to Modern Bank Card Systems," (1970), 18 University of Kansas Law Review 871 at 875.

42. B. Kozolchyk, "What Makes for a Classic in Commercial Letter of Credit Law," (1978), 2 - 3 Canadian Business Law Journal, p. 406.

43. (1970) 18 University of Kansas Law Review 871 at 876.

44. Falconbridge, Banking, p. 421.

45. (1846), 12 C.O. & F. 787 at 805.

46. Thompson, L.H., The Applicability of the Law of Letters of Credit to Modern Bank Card Systems, 18 University of Kansas Law Review (1970) 871 at 876, and note 50.

47. Ibid., 878.

48. T.M. Biscoe, Law and Practice of Credit Factoring, London, 1975 Butterworths, p. 3.

49. Ibid., p. 92.

50. Ibid., p. 3.

51. "Bank Credit Cards, Contemporary Problems," 41 Fordham Law Review, 373.

52. For more detail on the warrants see Gropper, The Credit Card in Canada, Canadian Consumer Council, pp. 37-65 (1970); McInnes, Credit Cards a Canadian Overview, Legal Research Institute of the University of Manitoba (1975) and Richey "Credit Card Laws" 4 U.C.L.A. Davis Law Review, 377.

53. Ibid., Richey, p. 389.

54. See Davis, The Law Relating to Commercial Letters of Credit, London, p. 145 (1963); Gutteridge & McGrah, The Law of Bankers' Commercial Credit, London, (1976).

55. See Falconbridge, Banking, p. 665, and McLaughlin, Introduction to Negotiable Instruments, London, 1975, p. 88; and see also section 188 - 192 especially section 191 of Bills of Exchange Act as amended by R.S.C. 1970 c. 4 (1st Supplement) s.l.

56. Binhammer, Deposit-Taking Institutions; Innovation and the Process of Change, Economic Council of Canada (1976).

57. Welling, Working Paper #6.
From B. Welling's draft working paper.

58. The constitutional validity of the Act was upheld by the S.C.C. in A.G. Ontario v. Barfried Enterprises [1963] SCR 570.

59. This extent may be the extent to which card transactions can be characterized as factoring arrangements. It will become clear below why this limit exists. Suffice to say at this point if the card transactions are characterized as bills of exchange, then the provincial jurisdiction over them would be much restricted.

60. From B. Welling's Working Paper, p. 25.

61. F.J. Jordan, Privacy, Computer Data Bank, and the Constitution. Privacy and Computer Task Force, p. 37.

62. B. Welling, Working Paper, p. 26.

63. Ibid.,p. 7 ff.

64. The quote is from Tennant & Union Bank of Canada [1894] A.C. 31. see also Abel, Laskin's Canadian Constitutional Law, 4th ed. ch. IX.

65. B. Welling's Working Paper, p. 6.

66. Ibid., p. 8.

67. P.N. McDonald,"The B.N.A. Act and the Near Banks: A Case Study in Federalism," Alta. Law Review, 1972: 10 pp. 155-217, p. 163.

68. Welling, p. 10.

69. _Ibid_., p. 13.

70. _Ibid_., p. 20.

71. _Bills of Exchange Act_, R.S.C. 1970, C. B-5.

72. See p. 11 ff. of this paper.

73. This is known as the rule of _Price_ v. _Neal_ (1762) 3 Burr. 1354, 97 E.R. 871.

74. The most likely reason this provision is now in the Banks' credit cards is because of U.S. legislation on the matter. See _Consumer Credit Protection Act_, 15 U.S.C.A. s. 1643, Pub. L. 90-321, Title 1 s. 132 as added Pub. L. 91-508, Title V, s. 502 (a) Oct. 26, 1970. 84 Stat. 1126.

75. Ralph Nader advocates a total prohibition of liability on the cardholder. See Brown, "Consumer Rights in Fund Transfer Originated at Electronic Fund Transfer Terminals." _Public Interest Research Group_, s. IV, Washington, (1976), On the other hand, the National Commission in the U.S. recommendations are similar to the ones found in this paper. See _EFT in the United States_, p. 58, Washington, (1977).

76. For a detailed discussion see Richey "The Apportionment of Credit Card Fraud Loss," 4 _U.C.D. Law Rev_., 377 at 378 (1971).

77. A good legislative example of a somewhat similar provision to what is suggested in the text can be found in Senator Donald W. Riegle's Bill. See s.2546, 95th Cong. 2d. Sess. s. 910, (1978). This bill received formal approval of the Senate Banking, Housing and Urban Affairs Committee on April 28th, 1978, 10 PSI, _Payment Systems Newsletter_ #5 p. 2 (May, 1978).

78. Pitch "Consumer Credit Reform: The Case for a Renewed Federal Initiative", 5 _Ottawa L.R_. 324.

79. Bill C-57 introduced into House of Commons on May 18, 1978 for first reading, in section 198 reproduces in identical form s. 92 of the present Act.

80. Savikas & Shandling, "Credit Cards - A Survey of the Bank Card Revolution and Applicability of the Uniform Commercial Code," 16 _De Paul L.R_. 387 at 408 (1976).

81. 15 U.S.C.A. 1601, Pub. L. 90-321 (1968) as amended.

82. Title 1, Consumer Credit Protection Act, 15 U.S.C.A. 1601 et seq.

83. Public Law 93-495 (1974).

84. Supra, note 77 section 905.

85. Pullen, The Impact of Truth in Lending Legislation: The Massachusetts Experience Federal Reserve Bank of Boston research report No. 43 (1968).

86. Commercial Law: Payment by Credit Transfer, Law Reform Commission of Canada W.P. 21 (Ottawa, 1978).

87. Ibid. p. 11-13.

88. Footnote 75, p. 17.

89. This proposition is cogently discussed at p. 42 of EFT in the United States, NCEFT (Washington, 1977) and is mentioned at p. 12 of Payment by Credit Transfer LRCC (Ottawa, 1978).

90. For an analysis of the drawbacks to the "disclosure" approach with respect to low income consumers see, Caplovitz, The Poor Pay More (2d ed. 1967);"Consumer Legislation and the Poor," 76 Yale L.J. (1967); Kripe,"A Consumer Credit Regulation: A Creditor Orientated Viewpoint", 68 Colum. L. Rev. 445 (1968); Testimony of Judge Brown, and the testimony of the Consumer Federation of American before the House Sub-Committee on Consumer Affairs in, Hearings on Consumer Credit Regulations of the House Banking and Currency Committee, 91st Cong. 1st Sess., pt. I (1969); Kawaja," The Case Against Regulating Consumer Credit Changes", 5 A. Bus. L.J. 319 (1969): Goudzwood "Price Ceilings & Credit Rationing", 23 J. of Fin. 177 (1968); Goudzwood,"Consumer Credit Charges", 35 So. Eco. J. 214 (1969).

91. EFT in the United States p. 72.

92. Pitch "Consumer Credit Reform: The Case for a Renewal Federal Initiative," 5 Ottawa L.R. 325 at 330 (1972).

93. ECC, Efficiency & Regulation, p.122.

94. Opinion Research Corporation, "Virginia Consumer Attitudes Toward Payment Systems" prepared for a committee of the Virginia Bankers Association (February, 1974) p. 47.

95. See discussion at p. 36 of the Evidence Working Paper.

96. Supra, note 77.

97. As amended by the Fair Credit Billing Act, Public Law 93-495.

98. Rogers, Falconbridge Banking and Bills of Exchange, p. 793 (7th ed.) (Toronto, 1969).

99. Under the United States Uniform Commercial Code Article 3 the exact opposite position prevails. Section 3-803 (1) (b) the obligation when the creditor receives the cheque until final payment or dishonouring of the cheque occurs.

100. Public Law 93-495 (1974).

101. Ibid.

102. For a discussion of final payment in connection with credit clearing see: Law Reform Commission of Canada, Payment by Credit Transfer, Ministry of Supply and Services (Ottawa, 1978) p. 71 - 75.

103. The essence of a cheque which is a specialized bill of exchange is that it is a written order by one person, the drawer, addressed to another person, the drawee, (always a bank in the case of a cheque), to pay a specified sum of money to a named person, the payee or to the bearer. A stop payment is really the drawer's right to countermand a cheque by written instruction to the bank under s. 167 of the Bills of Exchange Act. It only has the effect of not paying the payee for the right to countermand is solely one exercisable against the bank.

104. Bank of Montreal v. The King (1907) 38 S.C.R. 238 Imperial Bank of Canada v. Bank of Hamilton [1903] A.C. 49.

105. See clause 4 of the Merchant's Agreement in "Appendix A."

106. Eddy, The Canadian Payment System and the Computer: Issues for Law Reform, Information Canada, (Ottawa, 1974) p. 54 to 59.

107. EFT in the United States, NCEFT (Washington, 1977) p. 51.

108. Supra, note #77.

109. Similar provisions were contained in Ralph Nader's draft EFT code. See Brown, Consumer Rights in Fund Transfer Originated at Electronic Fund Transfer Terminals," Public Interest Research Group, s. IV, Washington, (1976).

110. PSI 10, Payments Systems Newsletter #5, May 1978.

111. Congressman Annunzio's bill is the equivalent House of Representatives bill to that of Senator Riegle. See H.R. 12775, 95th Cong. 2d Sess. s.907.

112. See clauses 4 (b) and (f) of agreement in Appendix A.

113. See Note, "Resort to the Legal Process in Collecting Debts from High Risk Credit Buyers in Los Angeles - Alternative Methods for Allocating Present Costs, 14 U.C.L.A. L. Rev. 879, 899-900 (1967).

114. R.S.O. 1970, c. 267.

115. R.S.O. 1970, c. 421.

116. S. 48.

117. O.L.R.C. Report on the Non-Possessory Repairman's Lien.

118. Only the first instalment of the larger project has been published to date O.L.R.C., Report on Consumer Warrants and Guarantees in the Sale of Goods, Dept. of Justice, (1977).

119. Killoran v. Monticello State Bank (1921) 61 S.C.R. 526.

120. Range v. Belvedere Finance 1969 S.C.R. 492 5 D.L.R. (3d) 257; Acceptance Corp. v. Richard (1975) 51 D.L.R. (3d) 559 which distinguishes the previous case.

121. R.S.C. 1970 (1st Supp.) c. 4, s. 1 adding Part V entitled Consumer Bills and Notes to the Act.

122. S.O. 1971 c. 24, s. 1 adding section 42 a to the Act.

123. For a discussion of some of the issues leading up to the legislative initiative see Ziegel, "Range v. Corporation de Belvedere - Consumer Notes - Status of Subsequent Holders - Need for Legislative Intervention" 48 C.B.R. 309 (1970).

124. See clause 6 of Appendix B.

125. Supra Note #103 p. 59.

126. See p. 43 of the text.

127. Public Law 93-495 (1974).

128. A very interesting analysis of the position of the various advocates on the question leading up to the enactment of the legislation may be found at Brandel & Leonard, "Bank Charge Cards: New Cash or New Credit" 69 Mich. L.R. 1032 at 1041 to 1068 (1971).

129. Ibid., p. 1062.

130. Ibid., p. 1064-1068.

131. Supra, note #112 p. 49-53.

132. ACFA "Comments on EFTS to Mr. H. Calef, Q.C. chairman. The Justice Group on EFTS" Toronto, (March, 1976). The ACFC is the national association of consumer loan, consumer sales finance and industrial and commercial credit companies operating in Canada. It has 35 members, all of whom are non deposit taking financial institutions.

133. Binhammer & Williams, Deposit-Taking Institutions: Innovation and the Process Change, Economic Council of Canada (Ottawa, 1976) p. 129.

134. Economic Council of Canada, Efficiency and Regulation: A Study of Deposit Institutions, Supply and Services, (Ottawa, 1976) p. 114.

135. Departments of Finance & Communications, Towards an Electronic Payments System, 7 (Information Canada (1975).

136. Supra, note #133 at p. 129.

137. Supra, note #134 at p. 134.

138. NCEFT. EFT in the United States, p. 91.

139. Prives, "Electronic Funds Transfer Systems & State Law" 93 Banking L.J. 527 (1976).

140. Franklin "Regulation of EFT Evolution," 37 U. of Pitt. L.R. 673 at 703 (1976).

141. Supra, note 139.

142. Ege, "EFT A Survey" 35 Maryland L.R. 47 (1975).

143. NCEFT, EFT in the United States, p. 97.

144. Senator McIntyre's Bill deals with financial institution issues involving EFTS. See s. 2293, 95th Cong., 1st Sess. (1977).

145. Brandel & Gresham, "Electronic Payments: Government Intervention a New Frontier for Private Initiative," 29 Bus. L. 1133 (1974).

146. Supra note #144.

147. See notes #133 and 134 and accompanying text.

958

CHARGEX MERCHANT'S MEMBER AGREEMENT

AGREEMENT between (the Bank)

and (the Merchant)

WHEREAS the Bank has undertaken to extend credit to holders of CHARGEX Credit Cards and the Merchant wishes to make available to its customers a convenient means of acquiring merchandise and services;

NOW THEREFORE the parties hereto agree as follows: —

1. The following terms used in this agreement shall have, except where inconsistent with the context, the following meanings:
   (a) "Credit Card" means an unexpired CHARGEX Credit Card or any other Credit Card bearing the distinctive Blue, White and Gold colour bands identical to those appearing on the CHARGEX Credit Card with which Merchant acknowledges he is familiar;
   (b) "Cardholder" shall mean the person whose name is embossed on a Credit Card;
   (c) "Authorized User" means a person, other than the Cardholder, whose signature appears on a Credit Card;
   (d) "Floor Limit" means the maximum amount authorized by the Bank in writing from time to time for which the Bank will be obliged to credit the Merchant's account in respect of any single transaction.

2. Upon presentation of a Credit Card by a Cardholder or an Authorized User, the Merchant agrees to sell merchandise to or perform services for the account of Cardholder at the same prices and upon the same conditions as those applicable to cash transactions.

The Merchant will invoice the Cardholder in respect of each transaction by completing a sales draft which shall be signed by the Cardholder or Authorized User to whom the Merchant will hand one copy thereof. The Merchant acknowledges receiving a copy of the form of sales draft.

3. The Merchant will maintain an account with the Bank at its branch, subject to the Bank's usual service charge for such account. Upon delivery to such branch of one or more properly completed sales drafts accompanied by a deposit envelope completed by the Merchant, the Bank will immediately credit such account with the amount of such sales drafts. The Merchant agrees to deposit each sales draft in its account within three business days of the transaction evidenced thereby. All deposit figures are subject to final audit by the Bank and, in case of any inaccuracies, the Bank shall charge or credit the Merchant's account, without notice, for any deficiencies or overages, as the case may be.

4. The Bank may refuse to credit the account of the Merchant with or may charge back to the Merchant the amount of any sales draft in any of the following circumstances: —
   (a) The signature appearing on the sales draft is or is claimed by the Cardholder to be forged or unauthorized;
   (b) The merchandise referred to in the sales draft has been returned or claimed by the Cardholder to have been returned to the Merchant or the services referred to in the sales draft are claimed by the Cardholder to have been unsatisfactory;
   (c) A sales draft exceeds the Floor Limit and has not been previously approved by the Bank;
   (d) A sales draft is illegible;
   (e) A sales draft refers to a Credit Card which has expired or which the Bank has notified the Merchant not to honour;
   (f) The transaction evidenced by the sales draft or any credit extended in respect thereof is, for any reason, illegal, null or invalid; or
   (g) The Merchant shall have failed to comply with the terms of this agreement.

The Bank will return to the Merchant a copy of any sales draft which in whole or in part it has refused to pay or has charged back to the Merchant.

5. All fees, charges or adjustments payable by the Merchant and the amount of any charge-back to or credit voucher issued by the Merchant shall constitute a debt payable on demand to the Bank for which the Bank may debit the Merchant's account, without prior notice. In the event that any such debit results in an overdraft in the Merchant's account, the Merchant will, on demand, pay the Bank the amount of such overdraft.

6. All claims by any Cardholder and all disputes respecting any transaction evidenced by a sales draft shall be settled directly between the Merchant and the Cardholder provided, however, that if any refund or other money adjustment is payable by the Merchant to the Cardholder, such refund or adjustment shall be made (unless the amount of such transaction has not been credited to the Merchant's account by the Bank or has been charged back to the Merchant) by means of the Merchant issuing a Credit voucher in respect thereof which shall be delivered to the Bank within three days of issuance.

7. The Merchant agrees to pay on signing this Agreement, an initial sign-up fee of $25.00

The Merchant also agrees to pay in advance a rental fee per annum, to be agreed upon from time to time, to the Bank for each imprinter required which rental may be debited automatically by the Bank to the Merchant's account, and Merchant acknowledges that such imprinter(s) will remain the exclusive property of the Bank.

The Merchant agrees to pay the Bank for its services hereunder fees in accordance with the applicable Discount Schedule which has been provided to the Merchant and which may be revised from time to time by mutual agreement of the parties.

8. The Bank shall not be entitled to any fee in respect of any amounts charged back to the Merchant or in respect of which credit vouchers have been issued by the Merchant.

9. The advertising and promotion of the CHARGEX Plan shall be conducted in the manner and under such terms as may be prescribed by the Bank.

10. Except for sales drafts the amount of which the Bank has refused to credit or has charged back to the Merchant, the Merchant shall have no right to receive payment in respect of a transaction evidenced by a sales draft from any party except the Bank.

11. This agreement shall remain in full force and effect unless terminated by either party upon at least five days' written notice of termination to the other party. All obligations of both parties in respect of any particular transaction entered into prior to the date of such termination shall survive such termination.

Upon such termination, all imprinters forms and other material bearing the name or trade mark of the Bank or the name CHARGEX shall be returned to the Bank forthwith and the Merchant thereafter shall not represent that he will honour CHARGEX Credit Cards issued by the Bank.

12. This agreement shall be binding upon the parties, their heirs, successors and assigns, provided however that the agreement shall not be assigned by the Merchant without the written consent of the Bank.

13. The Merchant will indemnify the Bank against and hold it harmless from all claims of whatsoever nature by any Cardholder or Authorized User arising out of any transaction evidenced by a sales draft.

14. The Bank may, from time to time, issue directions in writing regarding the procedure to be followed and prescribe forms to be used in carrying out the present agreement and such directions shall be binding upon the Merchant and the terms of such forms upon receipt thereof unless the Merchant elects to give immediate notice of cancellation of this agreement

15. Notices to be given hereunder shall be sent by prepaid mail to the parties at the following addresses: —

Bank:

Merchant:

Such notices shall be deemed to have been received on the day following the date of mailing.

IN WITNESS WHEREOF, the parties have caused this agreement to be executed at

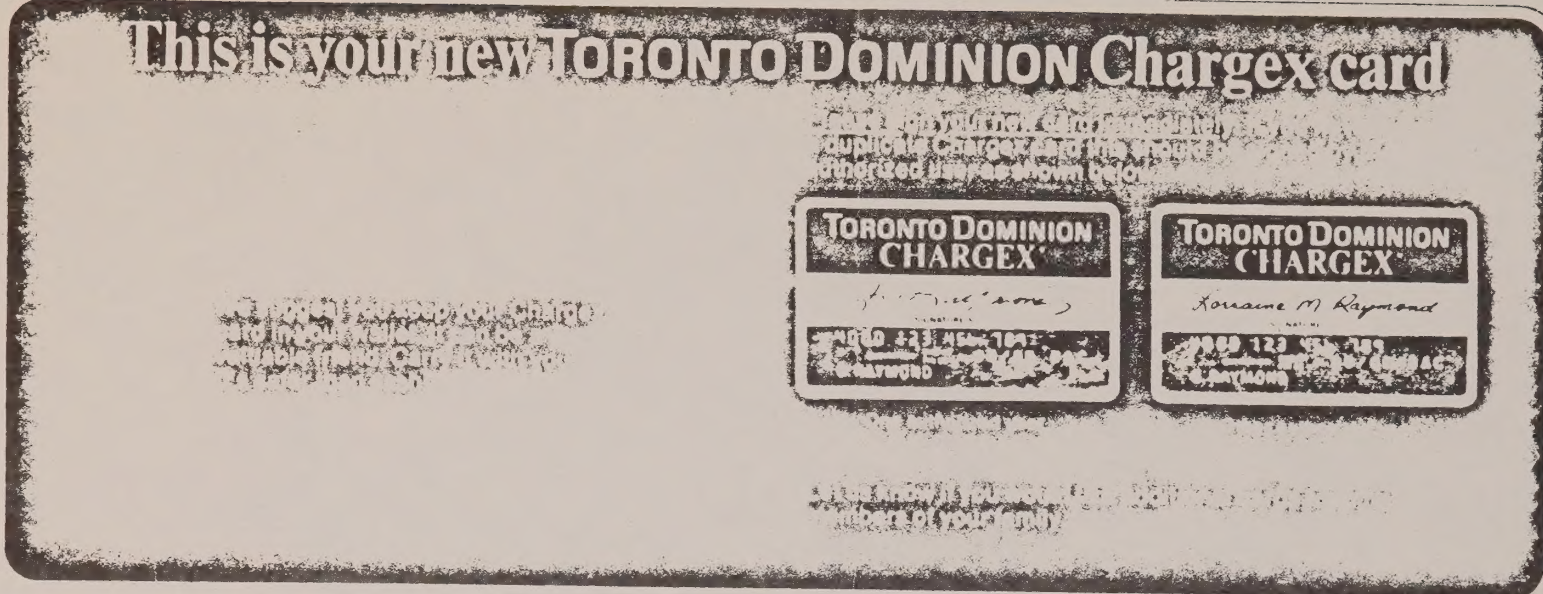
by their duly authorized officers on this day of 196 .

Bank authorization

Merchant authorization ....

CX400E

APPENDIX "B"



Chargex cardholder agreement

Signature on or use of any CHARGEX* CHARGE CARD ("Chargex Card") supplied to the person whose name is embossed thereon ("Cardholder") by the Cardholder or by a person authorized by the Cardholder to use same by having such person sign same in the space provided for signature on the face thereof will confirm agreement between the Cardholder and **THE TORONTO-DOMINION BANK** (the "Bank") as follows:

1. The Cardholder will pay to the Bank the amount of all sales drafts and cash advances in respect of which the Chargex Card has been used (the "Indebtedness") and any interest accrued thereon within twenty-five (25) days from the date of every monthly billing statement sent by the Bank to the Cardholder either —

(a) in full, in which case further interest may be payable only on cash advances as per clause 1(b)(ii) hereof, or

(b) by an instalment payment which is at least 5% or greater of the Indebtedness and any accrued interest thereon set forth on the billing statement with a minimum instalment payment of $10; or by such other minimum instalment payment as may be notified to the Cardholder from time to time.

Interest on the Indebtedness will be accrued, calculated and payable as follows:

(i) on the unpaid portion of Indebtedness (cash advances excepted) at the rate of 1½% per month (18% per annum) on amounts under $500.00 and at the rate of 1% per month (12% per annum) on excess, or at such other rates as may be notified to the Cardholder from time to time. Interest will be calculated on each statement date on any unpaid portion of Indebtedness which was billed on the previous month's statement.

(ii) on the entire Indebtedness relating to cash advances at the rate of 1½% per month (18% per annum) from the date the advances were obtained until the date payment is received by the Bank, or at such other rates as may be notified to the Cardholder from time to time.

2. The Chargex Card may be used to incur Indebtedness not in excess of the amount of credit extended by the Bank from time to time in respect of the use of the Chargex Card, and not after the expiry date embossed on the Chargex Card.

3. The Bank will not be liable if the Chargex Card is not honoured at any time. In the event of breach of any obligation hereunder by the Cardholder, the entire balance of the Cardholder's Indebtedness plus any accrued interest thereon shall, at the Bank's option, become immediately due and payable notwithstanding the provisions of Clause 1 hereof, and the Bank may in addition cancel this agreement and revoke the Chargex Card or Cards, which shall at all times be and continue to remain the property of the Bank and the Bank or any agent thereof may immediately take possession of same.

4. Cardholder is responsible for all Indebtedness resulting from authorized use of the Card and up to an aggregate maximum of $50, from unauthorized use until notification of loss or theft thereof has been received by the Bank.

5. If a merchant issues a Credit Voucher in respect of merchandise and/or services purchased through use of a Chargex Card, the Bank will, upon receipt of such Credit Voucher, credit the amount thereof to the Cardholder's account. Unless a Credit Voucher is received by the Bank, the Indebtedness is payable to the Bank, as provided above.

6. All claims including any rights of set-off by any Cardholder and all disputes respecting any transaction evidenced by a Sales Draft or Credit Voucher shall be settled directly between the merchant and the Cardholder.

*TM Reg'd

CX014 (6-71)